

PROCEEDINGS AND ORDERS

DATE: [05/19/94]

CASE NBR: [93100714] CFX

STATUS: [READY FOR ARGUMENT]

SHORT TITLE: [U.S. Bancorp Mortgage Co.
VERSUS [Bonner Mall Partnership]

DATE DOCKETED: [110293]

PAGE: [01]

-----DATE----NOTE-----PROCEEDINGS & ORDERS-----

- 1 Nov 2 1993 G Petition for writ of certiorari filed.
2 Nov 30 1993 Brief of respondent Bonner Mall Partnership in opposition filed.
4 Dec 3 1993 Brief amicus curiae of American Council of Life Insurance filed.
3 Dec 8 1993 DISTRIBUTED. January 7, 1994 (Page 17)
5 Jan 10 1994 Petition GRANTED.

6 Feb 14 1994 Record filed.
* Original proceedings United States District Court for the District of Idaho.
7 Feb 15 1994 Record filed.
* Partial proceedings United States Court of Appeals for the Ninth Circuit.
8 Feb 22 1994 Brief amicus curiae of Charles W. Adams filed.

PREVIOUS

1 1

EXIT

SHDWT

PROCEEDINGS AND ORDERS

DATE: [05/19/94]

CASE NBR: [93100714] CFX

STATUS: [READY FOR ARGUMENT]

SHORT TITLE: [U.S. Bancorp Mortgage Co.
VERSUS [Bonner Mall Partnership]

DATE DOCKETED: [110293]

PAGE: [02]

-----DATE----NOTE-----PROCEEDINGS & ORDERS-----

- 9 Feb 24 1994 Brief amicus curiae of United States filed.
10 Feb 24 1994 G Motion of American College of Real Estate Lawyers for leave to file a brief as amicus curiae filed.
12 Feb 24 1994 Joint appendix filed.
13 Feb 24 1994 Brief of petitioner U.S. Bancorp Mortgage Company filed.
14 Feb 24 1994 Brief amici curiae of American Council of Life Insurance, et al. filed.
19 Feb 24 1994 X Brief amici curiae of California Bankers Association, et al. filed.
11 Mar 1 1994 G Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
17 Mar 4 1994 CIRCULATED.
15 Mar 7 1994 Motion of American College of Real Estate Lawyers for leave to file a brief as amicus curiae GRANTED,

3 P

PROCEEDINGS AND ORDERS

DATE: [05/19/94]

CASE NBR: [93100714] CFX

SHORT TITLE: [U.S. Bancorp Mortgage Co.
VERSUS [Bonner Mall Partnership]

STATUS: [READY FOR ARGUMENT 1]

DATE DOCKETED: [110293]

PAGE: [031]

-----DATE----NOTE-----

PROCEEDINGS & ORDERS

- 16 Mar 7 1994 Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
- 20 Mar 15 1994 Suggestion of mootness filed by respondent.
- 21 Mar 15 1994 Response filed by petitioner to respondent's Suggestion of Mootness.
- 22 Mar 16 1994 Reply filed by respondent to petitioner's response to Suggestion of Mootness.
- 23 Mar 17 1994 Reply filed by petitioner to Suggestion of Mootness.
- 25 Mar 17 1994 Order extending time to file brief of respondent on the merits until April 1, 1994.
- 26 Mar 21 1994 DISTRIBUTED. March 25, 1994 (Page 15)
- 27 Mar 21 1994 X Reply brief of petitioner in support of request to vacate decision below filed.
- 28 Mar 28 1994 This case is removed for the April 1994 argument

PREVIOUS

1 1

EXIT

SHDKT PROCEEDINGS AND ORDERS

DATE: [05/19/94]

CASE NBR: [93100714] CFX

SHORT TITLE: [U.S. Bancorp Mortgage Co.
VERSUS [Bonner Mall Partnership]

STATUS: [READY FOR ARGUMENT 1]

DATE DOCKETED: [110293]

PAGE: [041]

-----DATE----NOTE-----

PROCEEDINGS & ORDERS

- 28 Mar 28 1994 This case is removed for the April 1994 argument calendar. The memorandum of respondent suggesting that the case is moot filed March 15, 1994 is set for briefing and oral argument in accordance with Rules 24, 25, and 28 of the Rules of this Court. The parties are directed to brief and argue the following question: Should the rule announced in *United States v. Munsingwear*, 340 U.S. 36 (1950), extend to cases that become moot in this Court because of the voluntary settlement of the parties?
- 31 Mar 29 1994 LODGING by amici curiae Credit Managers Association of California, et al. Twelve copies of amici brief.
- 29 Apr 4 1994 LODGING by respondent. Ten copies of respondent's brief.
- 30 Apr 4 1994 LODGING by amicus curiae Wabash Valley Power Association
Twelve copies of amicus brief.

PREVIOUS

Last page of docket

SHDKT

PROCEEDINGS AND ORDERS

DATE: [05/19/

CASE NBR: [93100714] CFX

SHORT TITLE: [U.S. Bancorp Mortgage Co.
VERSUS [Bonner Mall Partnership]

STATUS: [READY FOR ARGUMENT 1]

DATE DOCKETED: [110293]

PAGE: [041]

-----DATE----NOTE-----

PROCEEDINGS & ORDERS

- 33 May 10 1994 Order extending time to file brief of petitioner on the merits until May 17, 1994.
- 34 May 12 1994 Brief amicus curiae of United States filed.
- 35 May 17 1994 P Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.

93-714

No. 93-

Supreme Court, U.S.

FILED

NOV - 2 1993

OFFICE OF THE CLERK

IN THE
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,

Petitioner,

v.

BONNER MALL PARTNERSHIP,

Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Bradford Anderson*

Dale G. Higer

David B. Levant

* *Counsel of Record*

STOEL RIVES BOLEY JONES & GREY

3600 One Union Square

600 University Street

Seattle, WA 98101-3197

(206) 624-0900

Counsel for Petitioner

November 2, 1993

QUESTION PRESENTED

Whether the new value exception to the absolute priority rule survived enactment of the Bankruptcy Reform Act of 1978, permitting the debtor in a Chapter 11 bankruptcy case to confirm a nonconsensual plan of reorganization which allows the debtor's equityholders to retain ownership of the reorganized debtor while paying objecting creditors less than the full amount of their claims.

TABLE OF CONTENTS

	<i>Page</i>
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY PROVISION INVOLVED	2
STATEMENT OF THE CASE	3
I. Basis for Federal Jurisdiction	3
II. Statement of Facts	3
III. Procedural History	6
ARGUMENT FOR ALLOWANCE OF THE WRIT	7
I. Survival of the New Value Exception is an Important, Unsettled Question of Federal Law	8
II. The Decision Below Conflicts with Applicable Decisions of this Court	10
A. Conflict with <i>Ahlers</i>	10
B. Conflict with the <i>Midlantic</i> Line of Cases	12
III. The New Value Exception has Generated Conflicting Decisions between and within the Courts of Appeal	13
CONCLUSION	16

TABLE OF AUTHORITIES

	<i>Page</i>
Cases:	
<i>In re A.V.B.I., Inc.</i> , 143 B.R. 738 (Bankr. C.D. Cal. 1992).....	16
<i>Case v. Los Angeles Lumber Products Co.</i> , 308 U.S. 106 (1939)	7
<i>Dewsnup v. Timm</i> , 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992).....	12,13
<i>In re Drimmel</i> , 108 B.R. 284 (Bankr. D. Kan. 1989)	16
<i>First Republic Thrift & Loan of San Diego v. Triple R Holdings, L.P. (In re Triple R Holdings, L.P.)</i> , 145 B.R. 57 (N.D. Cal. 1992).....	16
<i>Griffin v. Oceanic Contractors, Inc.</i> , 458 U.S. 564 (1982)	13
<i>Kelly v. Robinson</i> , 479 U.S. 36 (1986).....	12
<i>Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting</i> , 908 F.2d 1351 (7th Cir. 1990)	8,14
<i>Lumber Exch. Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exch. Ltd. Partnership)</i> , 125 B.R. 1000 (Bankr. D. Minn. 1991).....	15
<i>Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Pro- tection</i> , 474 U.S. 494 (1986).....	10,12
<i>In re Montgomery Court Apartments, Ltd.</i> , 141 B.R. 324 (Bankr. S.D. Ohio 1992)	16
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988)	7,9,11
<i>Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)</i> , 781 F.2d 99 (7th Cir. 1986)	14

TABLE OF AUTHORITIES (continued)

Cases (continued)	Page
<i>In re Outlook/Century Ltd.</i> , 127 B.R. 650 (Bankr. N.D. Cal. 1991).....	16
<i>Patterson v. Shumate</i> , 504 U.S. ___, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992).....	13
<i>Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership)</i> , 134 B.R. 165 (Bankr. D. Md. 1991)	16
<i>Pennsylvania Dept. of Public Welfare v. Davenport</i> , 495 U.S. 552 (1990).....	12,13
<i>Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)</i> , 995 F.2d 1274 (5th Cir. 1992)	8,14
<i>Piedmont Assocs. v. CIGNA Property & Casualty Ins. Co.</i> , 132 B.R. 75 (N.D. Ga. 1991).....	16
<i>Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)</i> , 147 B.R. 763 (C.D. Cal. 1992).....	16
<i>In re SLC Ltd. V</i> , 137 B.R. 847 (Bankr. D. Utah 1992)	16
<i>Snyder v. Farm Credit Bank of St. Louis (In re Snyder)</i> , 967 F.2d 1126 (7th Cir. 1992)	14
<i>In re Sovereign Group 1985-27, Ltd.</i> , 142 B.R. 702 (E.D. Pa. 1992)	16
<i>In re Stegall</i> , 865 F.2d 140 (7th Cir. 1989).....	14
<i>Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)</i> , 800 F.2d 581 (6th Cir. 1986)	14

TABLE OF AUTHORITIES (continued)

Cases (continued)	Page
<i>Toibb v. Radloff</i> , 501 U.S. ___, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (1991)	13
<i>Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII)</i> , 961 F.2d 496 (4th Cir. 1992)	15
<i>United States v. Ron Pair Enters., Inc.</i> , 489 U.S. 235 (1989)	12,13
<i>In re Winters</i> , 99 B.R. 658 (Bankr. W.D. Pa. 1989).....	16
Statutes:	
11 U.S.C. § 362	4
11 U.S.C. § 1101	4
11 U.S.C. § 1107	4
11 U.S.C. § 1129	2,5,10,11
28 U.S.C. § 157(b)	3
28 U.S.C. § 158(a).....	3
28 U.S.C. § 158(d)	3,6
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1334	3

IN THE
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner.

v.

BONNER MALL PARTNERSHIP,
Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

U.S. Bancorp Mortgage Company ("U.S. Bancorp")¹ petitions this Court for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit to review the judgment in *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership)*, 2 F.3d 899 (9th Cir. 1993). Respondent is Bonner Mall Partnership ("Bonner"), a debtor in possession under Chapter 11 of the Bankruptcy Code.

OPINIONS BELOW

On December 6, 1991, the United States Bankruptcy Court for the District of Idaho decided to grant U.S. Bancorp relief from the automatic stay to foreclose Bonner's sole significant asset. The Bankruptcy Court's Memorandum of Decision is unofficially

¹ The parent corporation of U.S. Bancorp Mortgage Company is U.S. Bancorp. U.S. Bancorp Mortgage Company is affiliated with U.S. Bank of Oregon, U.S. Bank of Washington, and U.S. Bank of California.

reported at 1991 Bankr. LEXIS 1402, 1991 WL 330784 and reprinted at Appendix A118-29. The Bankruptcy Court entered a separate Order Denying Motion to Dismiss and Granting Motion for Relief from Stay on December 11, 1991. The United States District Court for the District of Idaho reversed the Bankruptcy Court's decision on July 15, 1992, and entered a further Correction Order on July 23, 1992. The District Court's Opinion and Order, as corrected, is reported at 142 B.R. 911 and reprinted at Appendix A88-117. Such Order was affirmed by the Court of Appeals for the Ninth Circuit pursuant to an Opinion and separate Order filed and entered on August 4, 1993. The Court of Appeals' Opinion is reported at 2 F.3d 899 and reprinted at Appendix A1-84.

JURISDICTION

This petition arises under the Bankruptcy Reform Act of 1978 (the "Bankruptcy Code"), 11 U.S.C. § 101 *et seq.* The date of the decision of the Court of Appeals for the Ninth Circuit is August 4, 1993. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 1129 of the Bankruptcy Code, 11 U.S.C. § 1129, provides in relevant part:

(a) The court shall confirm a plan only if all of the following requirements are met:

...

(8) With respect to each class of claims or interests--

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

...

(b) (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

...

(B) With respect to a class of unsecured claims--

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

STATEMENT OF THE CASE

I. Basis for Federal Jurisdiction

The jurisdiction of the Bankruptcy Court was invoked under 28 U.S.C. §§ 1334 and 157(b). The jurisdiction of the District Court was invoked under 28 U.S.C. § 158(a). The jurisdiction of the Court of Appeals was invoked under 28 U.S.C. § 158(d).

II. Statement of Facts

This case concerns the ability of Bonner's equityholders to retain their ownership of the Bonner Mall (the "Mall"), a shopping

center located in Bonner County, Idaho. The Mall was built by Northtown Investments using a \$6.3 million loan from First National Bank of North Idaho. Northtown Investments signed a note and a deed of trust on the Mall. U.S. Bancorp acquired the note and deed of trust in 1986.

Bonner is an Idaho general partnership that was formed for the purpose of acquiring and operating the Mall. On October 31, 1986, Bonner purchased the Mall from Northtown Investments, subject to U.S. Bancorp's lien on the Mall. The Mall is Bonner's only significant asset.

The Mall turned out to be a bad investment, and Bonner has been unable to pay its expenses out of the Mall's income. Bonner serviced the debt to U.S. Bancorp until July 1, 1990 by deferring maintenance and repairs to the Mall and by not paying its real estate taxes to Bonner County.

On July 10, 1990, U.S. Bancorp commenced a nonjudicial foreclosure of the Mall because of Bonner's failure to pay real estate taxes on the Mall, commencing with 1987 taxes. U.S. Bancorp agreed to three requests by Bonner to postpone the foreclosure sale of the Mall, finally resetting the sale for March 14, 1991. On March 13, 1991, Bonner filed a petition under Chapter 11 of the Bankruptcy Code. Bonner is a debtor-in-possession pursuant to 11 U.S.C. §§ 1101 and 1107.

On April 23, 1991, U.S. Bancorp moved for relief from the automatic stay, *see* 11 U.S.C. § 362, to foreclose its interest in the Mall on the grounds, among others, that Bonner could not confirm a plan of reorganization. The Bankruptcy Court denied relief, subject to the proviso that Bonner propose a plan of reorganization that was not unconfirmable as a matter of law. The Bankruptcy Court also valued the Mall at \$3.2 million.

On October 31, 1991, Bonner filed its First Amended Plan of Reorganization (the "Plan") and related First Amended Disclosure Statement. Under the Plan, Bonner would transfer all of its assets to

a new entity, Bonner Properties, Inc. ("Bonner Properties") in return for Bonner Properties' assumption of Bonner's liabilities as set forth in the Plan.

The Plan provided that the \$3.2 million portion of U.S. Bancorp's claim which is fully secured by the Mall would be paid 32 months after the Plan's confirmation, with 7% annual interest payable monthly in the interim. Other secured creditors also would be paid the value of their collateral on a deferred basis. No cash whatsoever would be distributed with respect to more than \$3.6 million in unsecured claims against Bonner, including the undersecured portion of U.S. Bancorp's claim, which constituted approximately 93% of all unsecured claims. Instead, all unsecured claims of more than \$1,000 would be satisfied through a pro-rata distribution of 300,000 shares of Bonner Properties redeemable preferred stock having a par value and liquidation preference of \$300,000. Thirty-two months after the Plan's confirmation, the preferred stock would be convertible into 15% of the then-outstanding common stock of Bonner Properties.

Under the Plan, Bonner's existing partners would contribute to Bonner Properties \$200,000 cash and a 32-month undertaking to fund any shortfall in Bonner Properties' working capital in return for 2,000,000 shares (100%) of Bonner Properties common stock. The Plan would give Bonner's partners the exclusive right to acquire the common stock, except for the shares which could be issued to unsecured creditors upon the conversion of the preferred stock.

The Plan does not meet the requirements of Section 1129(b)(2)(B)(i) of the Bankruptcy Code, *see supra* page 3, because the holders of more than \$3.6 million of unsecured claims are to receive only \$300,000 in liquidation value of preferred stock. Accordingly, the Plan can only be confirmed under Section 1129(b) of the Bankruptcy Code (a "cramdown" confirmation) if Section 1129(b)(2)(B)(ii) is satisfied. The requirement of Section 1129(b)(2)(B)(ii) embodies what is known as the "absolute priority rule." The Plan violates the absolute priority rule because Bonner's owners will retain property under the Plan, despite the failure to pay

unsecured claims in full. The Plan therefore can be confirmed only if there is an exception or corollary to the absolute priority rule which permits a debtor's owners to contribute new value to the reorganized debtor in return for the property they receive or retain under the plan of reorganization. Bonner relies on such a "new value" exception or corollary to the absolute priority rule to confirm the Plan.²

III. Procedural History

In response to Bonner's Plan, U.S. Bancorp renewed its motion for relief from the automatic stay to foreclose its interest in the Mall. U.S. Bancorp argued that the Plan was unconfirmable as a matter of law because it relied on the new value exception to the absolute priority rule. The Bankruptcy Court agreed, holding that the new value exception did not survive enactment of the Bankruptcy Code, and issued on December 6, 1991 the Memorandum of Decision reprinted at Appendix A118-29. The Bankruptcy Court stayed its decision pending appeal.

On July 15, 1992, the District Court reversed the Bankruptcy Court's Order and held that the new value exception survived enactment of the Bankruptcy Code. *See Appendix A88-117.* The District Court remanded the case to the Bankruptcy Court for further proceedings.

U.S. Bancorp appealed the District Court's decision to the Court of Appeals for the Ninth Circuit. The Court of Appeals requested supplemental briefing by the parties on the question whether, in light of the remand of the case to the Bankruptcy Court, the District Court's decision was a final order for purposes of 28 U.S.C. § 158(d).

On August 4, 1993, the Court of Appeals issued its Opinion. *See Appendix A1-84.* It agreed with the parties that the District Court's decision was a final order for purposes of 28 U.S.C. § 158(d).

reasoning that the central issue in the appeal was legal in nature and its resolution could clearly dispose of the case and obviate the need for factfinding. *See Appendix A12-19.* The Court of Appeals then affirmed the decision of the District Court and remanded the case to the Bankruptcy Court for further proceedings.

ARGUMENT FOR ALLOWANCE OF THE WRIT

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), this Court recognized in dicta a new value exception to the absolute priority rule under the Bankruptcy Act of 1898 (the "Bankruptcy Act"). In 1978 the Bankruptcy Code replaced the Bankruptcy Act. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court questioned, but did not decide, whether the new value exception survived enactment of the Bankruptcy Code. *Id.* at 203 n.3. This case raises the same question.

In its decision below, the Court of Appeals for the Ninth Circuit noted that—

Whether [the new value exception] is viable under the Bankruptcy Code has significant implications for the relative bargaining power of debtors and creditors in Chapter 11 cases. Although no circuit court has taken a definitive position on this question, *dicta* in several opinions demonstrate intra- and inter-circuit disagreements. District and bankruptcy courts are sharply divided on the question, as are the commentators. The question will in all probability ultimately be decided by the Supreme Court.

Appendix A2-3.

² The Plan has been amended in various regards since the Court of Appeals' decision, but still relies on the new value exception.

I. Survival of the New Value Exception is an Important, Unsettled Question of Federal Law

The survival of the new value exception is an important question of federal law which has not been, but should be, settled by this Court.

The Court of Appeals is correct in its statement that survival of the new value exception has significant implications for the relative positions of debtors and creditors in Chapter 11 cases. The new value exception would profoundly diminish creditors' control over the reorganization process. As the Court of Appeals for the Seventh Circuit explained in *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, *reh'g and reh'g en banc denied* (7th Cir. 1990), "A 'new value exception' means a power in the judge to 'sell' stock to the managers even when the creditors believe that this transaction will *not* augment the value of the firm." *Id.* at 1360 (emphasis in original). The Court of Appeals for the Fifth Circuit has expanded on this point:

[P]ermitting the courts, pursuant to a "new value exception," rather than the creditors, under a strict absolute priority rule, to determine the conditions of former equity owners' participation in a reorganized debtor introduces an enormously complicating factor in a carefully balanced bargaining structure. . . . Creditors and the debtor [would be] left to guess, *not what each other's "bottom line" position is* for a consensual plan, *but rather what the particular court sees* as a "bottom line" cash contribution that will permit cramdown of an old equity plan under the "new value exception." . . . Negotiations between creditors and the debtor against such a "new value exception" backdrop would be enormously skewed in favor of old equity and would seriously erode the utility of the creditors' votes.

Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture), 948 F.2d 134, 144 (1991) (emphasis in original), *petition for reh'g granted in part, opinion withdrawn in relevant part*, 995 F.2d 1274, 1284 (5th Cir.) (per curiam) (Jones, J.,

dissenting from withdrawal), *cert. denied*, ___ U.S. ___, 113 S. Ct. 72, 121 L. Ed. 2d 37 (1992).

This issue occurs frequently in bankruptcy cases and is of considerable importance to the lending community. The issue raises significant public policy considerations in that the existence of the new value exception adds tremendous uncertainty to credit markets. The new value exception in essence allows a bankruptcy court to write new loans for lenders on terms they never envisioned and which, in their business judgment, they would not consider prudent. In that regard, U.S. Bancorp understands that other lenders and associations of lenders are likely to request permission to file amicus briefs in support of this petition and, if certiorari is granted, on the merits.

The determination whether the new value exception survives also implicates the broader issue of application of doctrines created by the courts under the Bankruptcy Act to cases administered under the Bankruptcy Code. See *infra* pages 12-13. These issues relate solely to federal law.

The survival of the new value exception has not been settled by this Court. In the *Ahlers* case the Solicitor General of the United States, as *amicus curiae*, urged this Court to hold that codification of the absolute priority rule in the Bankruptcy Code eliminated any new value exception. 485 U.S. at 203 n.3. This Court refused the Solicitor General's suggestion because it did not need to reach the survival of the new value exception to resolve the issues before it in *Ahlers*. "Thus, our decision today should not be taken as any comment on the continuing vitality of the Los Angeles Lumber exception--a question which has divided the lower courts since passage of the Code in 1978." *Id.* This issue, and the question of statutory interpretation of the Code, remains very much in dispute. See *infra* pages 13-16.

II. The Decision Below Conflicts with Applicable Decisions of this Court

The Court of Appeals' decision conflicts both with this Court's decision in the *Ahlers* case and a line of this Court's decisions interpreting the Bankruptcy Code originating with *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494 (1986).

A. Conflict with *Ahlers*

At the heart of the Court of Appeals' decision in this case is the view that the new value principle is a "corollary," not an exception, to the absolute priority rule:

We have no difficulty in reconciling the "on account of" language with the new value exception. . . . Several courts have concluded that if a proposed plan satisfies [the requirements of] the new value exception, it will not violate section 1129(b)(2)(B)(ii) of the Code and the absolute priority rule. Such a plan, they reason, will *not* give old equity property "on account of" prior interests, but instead will allow the former owners to participate in the reorganized debtor *on account of* a substantial, necessary, and fair new value contribution. We agree with their analysis.

We recognize that in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners. But it is also true that in new value transactions old equity owners receive stock in exchange for the additional capital they invest. Causation for any event has many and varied levels. Here, the answer to the meaning of the phrase "on account of" lies in the level of causation Congress had in mind when it prohibited old equity owners from receiving property "on account of" their prior interests. A reading of the full text of section 1129(b)(2)(B)(ii) makes it clear that what Congress had in mind was direct or immediate causation rather than a more remote variety, and that it did not intend to prohibit persons who receive stock because they have provided new capital from becoming participants in the

reorganized debtor simply because they were also owners of the original enterprise.

Appendix A37-40 (citations and footnote omitted) (emphasis in original).³

The Court of Appeals' conclusion that "A qualifying plan simply does not violate the absolute priority rule," Appendix A42 n.25, is directly at odds with this Court's decision in *Ahlers*, where this Court wrote that "There is little doubt that a reorganization plan in which [debtors] retain an equity interest in the farm is contrary to the absolute priority rule." 485 U.S. at 202 (footnote omitted).⁴ Footnote 3 to that decision repeatedly refers to the *Los Angeles Lumber* "exception" to the absolute priority rule. *Id.* at 203 n.3.

By characterizing the new value exception as an extra-statutory corollary to the Bankruptcy Code, rather than an exception to the Code's absolute priority rule, the Court of Appeals shifted the burden to U.S. Bancorp to prove that Congress repealed the new value exception. If, as indicated by this Court in *Ahlers*, the new value principle is in fact an exception to the Bankruptcy Code, the burden of proving its survival after enactment of the Bankruptcy Code should have fallen on Bonner. The Court of Appeals' disregard of this Court's characterization of the new value principle therefore infected its subsequent application of this Court's decisions establishing the proper approach to Bankruptcy Code interpretation.

³ The Court of Appeals reasoned that U.S. Bancorp's contrary interpretation of "on account of" would render the phrase superfluous. "Had Congress intended that old equity never receive any property under a reorganization plan where senior claim classes are not paid in full, it could simply have omitted the 'on account of' language from section 1129(b)(2)(B)(ii)." Appendix A40. This is not correct. Holders of junior claims and interests can also hold senior claims. The "on account of" language thus, at a minimum, serves the purpose of allowing such holders to receive property under a plan with respect to their senior claims, though they are barred from receiving property on account of their junior claims or interests if other senior claims are not paid in full.

⁴ The debtors did not contest this conclusion in *Ahlers*. *Id.* at 202 n.2.

B. Conflict with the *Midlantic* Line of Cases

The Court of Appeals' decision also conflicts with this Court's carefully elaborated approach, commencing with *Midlantic* and continuing through *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), to resolution of conflicts between pre-Code judicially-created rules and the Bankruptcy Code.

The Court of Appeals relied on the decisions in *Midlantic*, *Kelly v. Robinson*, 479 U.S. 36 (1986), *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552 (1990), and *Dewsnup*, see Appendix A51-61, without due regard for the context of those decisions or the dictates of this Court in *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989), and *Dewsnup*. On the basis of its reading of such cases, the Court of Appeals concluded that "Where the text of the Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended it to continue unless the legislative history dictates a contrary result." Appendix A57 (citing *Dewsnup*, 112 S. Ct. at 779).

That conclusion is at odds with the principles set forth in *Ron Pair*:

Kelly and *Midlantic* make clear that, in an appropriate case, a court must determine whether Congress has expressed an intent to change the interpretation of a judicially created concept in enacting the Code. But *Midlantic* and *Kelly* suggest that there are limits to what may constitute an appropriate case. Both decisions concerned statutory language which, at least to some degree, was open to interpretation. Each involved a situation where bankruptcy law, under the proposed interpretation, was in clear conflict with state or federal laws of great importance.

489 U.S. at 245. See also *id.* at 243-45 (explaining particular circumstances of *Midlantic* and *Kelly* cases).

In the *Davenport* case, this Court enforced the plain meaning of the Bankruptcy Code despite the Code's abrogation of pre-Code

practice, see 495 U.S. at 560-64, and despite the Code's effect on States' administration of their criminal justice systems. No such countervailing nonbankruptcy policies are implicated by the new value exception. And *Ron Pair*'s threshold requirement that the applicable provision of the Bankruptcy Code be textually ambiguous or rendered uncertain by a clear conflict with other laws of great importance was faithfully followed in *Dewsnup*:

[W]here the language is unambiguous, silence in the legislative history cannot be controlling. But, given the ambiguity here, to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent they become "unsecured" for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles.

112 S. Ct. at 779, 116 L. Ed. 2d at 913.

The Court of Appeals ignored the requirement that Section 1129(b)(2)(B)(ii) be open to interpretation or in clear conflict with other laws of great importance before importing pre-Code practice into the Bankruptcy Code. Instead, contrary to *Ron Pair*, it placed the burden on U.S. Bancorp to prove "a clear intent on the part of Congress to eliminate the new value exception." See Appendix A61.⁵

III. The New Value Exception has Generated Conflicting Decisions between and within the Courts of Appeal

While the decisions of other Courts of Appeal have stopped short of deciding the survival of the new value exception, they have

⁵ The Court of Appeals therefore disregarded U.S. Bancorp's argument that this Court's decisions in *Patterson v. Shumate*, 504 U.S. ___, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992), *Toibb v. Radloff*, 501 U.S. ___, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (1991), *Ron Pair*, and *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564 (1982), set a high standard for finding ambiguities in a Bankruptcy Code section that is susceptible to a literal application which is not in conflict with other laws.

gone far enough to evidence a serious conflict in views over this issue, have spawned directly conflicting decisions in the lower courts, and have fostered an unusual degree of uncertainty and confusion in this important area of federal law.

Among the Courts of Appeal, the Sixth and Seventh Circuits upheld plans based on the new value exception prior to this Court's decision in the *Ahlers* case. See *Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)*, 800 F.2d 581 (6th Cir. 1986), and *Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)*, 781 F.2d 99 (7th Cir. 1986). Both decisions assumed without deciding that the new value exception survived under the Bankruptcy Code. Since the *Ahlers* decision, the Seventh Circuit has issued a pair of directly conflicting opinions in *Kham & Nate's*, 908 F.2d 1351 (7th Cir. 1990) (Easterbrook, J.) (questioning continuing vitality of exception in dicta), and *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126 (7th Cir. 1992) (Cudahy, J.) (defending exception in dicta).⁶

In late 1991, the Fifth Circuit flatly rejected the new value exception in part IV of its decision in *Greystone III Joint Venture*, 948 F.2d 134, 142-44 (5th Cir. 1991), which was intended to give guidance to the bankruptcy court on remand. The Fifth Circuit withdrew that part of its decision four months later, apparently in response to this Court's decision in the *Dewsnup* case. See 995 F.2d 1274, 1284-85. Judge Edith Jones, the author of the original decision, dissented from withdrawal of the new value exception portion of the decision: "I would hope to stand with Galileo, who, rebuffed by a higher temporal authority, muttered under his breath, 'Eppur si muove.' ('And yet it moves.')" *Id.* at 1285.

In April 1992, the Fourth Circuit questioned the vitality of the new value exception and rejected a new value plan which gave the debtor's old equityholders the exclusive right to contribute new capital to the reorganized debtor without exposing the debtor's property to the market or giving other parties in interest the opportunity to bid for it. *Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII)*, 961 F.2d 496 (4th Cir.), cert. denied, ___ U.S. ___, 113 S. Ct. 191, 121 L. Ed. 2d 134 (1992). "[E]ven if some limited new capital exception were viable under the Bankruptcy Code, it would not be so expansive as to apply under the facts of this case." 961 F.2d at 505.

While the Fourth Circuit's decision in *Bryson Properties* does not definitively reject the new value exception, it does appear irreconcilable with the Ninth Circuit's decision in this case on the critical issue whether equityholders receive property "on account of" their prior interest in the debtor under new value plans that do not afford other parties an opportunity to participate in the reorganized debtor on an equal footing. Compare Appendix A43-51 (old equityholders receive property in exchange for new value) with 961 F.2d 504-05 & n.14 (old equityholders' exclusive right under plan to contribute new value constitutes property received or retained on account of old interests).

Finally, both the Eighth and the Tenth Circuits have let stand, without addressing the viability of the new value exception, Bankruptcy Court decisions repudiating the exception in *Lumber Exch. Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exch. Ltd. Partnership)*, 125 B.R. 1000 (Bankr. D. Minn.), aff'd on other grounds, 134 B.R. 354 (D. Minn. 1991), aff'd, 968 F.2d 647 (8th Cir. 1992), and *In re Drimmel*, 108 B.R. 284 (Bankr. D. Kan. 1989), aff'd, 135 B.R. 410 (D. Kan. 1991), aff'd on other grounds sub nom. *Unruh v. Rushville State Bank of Rushville, Mo.*, 987 F.2d 1506 (10th Cir. 1993).

The uncertainty and conflict inherent in these decisions of the Courts of Appeal are reflected in decisions of the Bankruptcy Courts

⁶ A third decision of the Seventh Circuit, *In re Stegall*, 865 F.2d 140 (7th Cir. 1989), applied the exception to a new value plan but expressly recognized that the survival of the exception was an open question.

and District Courts, some of which have squarely embraced or rejected the new value exception. Among the recent cases which have held that the new value exception survived enactment of the Bankruptcy Code are: *Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)*, 147 B.R. 763 (C.D. Cal. 1992), *appeal docketed*, No. 93-55055 (9th Cir. Jan. 13, 1993); *In re Sovereign Group 1985-27, Ltd.*, 142 B.R. 702 (E.D. Pa. 1992); *In re Montgomery Court Apartments, Ltd.*, 141 B.R. 324 (Bankr. S.D. Ohio 1992); *In re SLC Ltd. V.*, 137 B.R. 847 (Bankr. D. Utah 1992); and *Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership)*, 134 B.R. 165 (Bankr. D. Md. 1991). Among the lower court decisions, in addition to those cited in the previous paragraph, which have rejected the new value exception are: *First Republic Thrift & Loan of San Diego v. Triple R Holdings, L.P. (In re Triple R Holdings, L.P.)*, 145 B.R. 57 (N.D. Cal. 1992) (adopting the reasoning set forth in *In re Outlook/Century Ltd.*, 127 B.R. 650 (Bankr. N.D. Cal. 1991)); *Piedmont Assocs. v. CIGNA Property & Casualty Ins. Co.*, 132 B.R. 75 (N.D. Ga. 1991); *In re A.V.B.I., Inc.*, 143 B.R. 738 (Bankr. C.D. Cal. 1992); and *In re Winters*, 99 B.R. 658 (Bankr. W.D. Pa. 1989).

The question whether the new value exception survived enactment of the Bankruptcy Code has now been thoroughly debated by the courts, and new decisions appear to be lining up with earlier decisions, rather than offering new insights in their analysis of the issues. The passage of time therefore will likely defer, not facilitate, resolution of the issue posed by this case. The Ninth Circuit's prediction that the survival of the new value exception ultimately will have to be decided by this Court, *see supra* page 7, thus appears accurate.

CONCLUSION

Five years ago, this Court questioned the survival of the new value exception after enactment of the Bankruptcy Code, but reserved decision of the issue for another case. In the interim, the Courts of Appeal, District Courts and Bankruptcy Courts have produced a

significant number of conflicting decisions on this important but unsettled question of federal law. The Court of Appeals for the Ninth Circuit has now squarely decided in this case that the new value exception is a viable corollary to the Bankruptcy Code, unaltered by Congress' overhaul of the Bankruptcy Act.

The resolution of the issue in this case follows from a misinterpretation of Section 1129(b)(2)(B)(ii) of the Bankruptcy Code that conflicts with this Court's decision in *Ahlers* and the Fourth Circuit's decision in *Bryson Properties*. The decision below also misapplies the principles of Bankruptcy Code interpretation established by this Court in the line of cases commencing with *Midlantic*.

For the foregoing reasons, this Court should grant a writ of certiorari to the Court of Appeals for the Ninth Circuit to review its decision in this case and resolve the question whether the new value exception survived enactment of the Bankruptcy Code.

Respectfully submitted,

Bradford Anderson*

Dale G. Higer

David B. Levant

* Counsel of Record

STOEL RIVES BOLEY JONES & GREY
3600 One Union Square
600 University Street
Seattle, WA 98101-3197
(206) 624-0900

Counsel for Petitioner

TABLE OF CONTENTS

OPINION AND ORDER, UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT	A1
NOTICE OF APPEAL	A85
CORRECTION ORDER	A88
OPINION AND ORDER, UNITED STATES DISTRICT COURT FOR THE DISTRICT OF IDAHO	A90
MEMORANDUM OF DECISION, UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF IDAHO	A118

In re BONNER MALL PARTNERSHIP, Debtor.
Bonner Mall Partnership,
Plaintiff-Appellee,

v.

U.S. BANCORP MORTGAGE CO.,
Defendant-Appellant.

No. 92-36754.

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted March 2, 1993.
Decided Aug. 4, 1993.

Creditor moved for relief from the automatic stay and for dismissal of Chapter 11 debtor's case, alleging debtor's plan providing for preferential treatment of debtor's equity holders in exchange for additional capital contribution and real property was not confirmable as matter of law. The Bankruptcy Court, Alfred C. Hagan, Chief Judge, granted relief from the United States District Court for the District of Idaho, 142 B.R. 911, Harold L. Ryan, J., reversed and remanded, holding that the new value exception to the absolute priority rule survived enactment of Bankruptcy Code, and creditor appealed. The Court of Appeals, Reinhardt, Circuit Judge, held that: (1) bankruptcy court order granting relief from stay was final for appeal purposes, and (2) new value exception survived enactment of the Code.

Judgment of district court affirmed and remanded.

Bradford Anderson, Stoel, Rives, Boley, Jones & Grey, Seattle, WA (argued); Dale G. Higer, Stoel, Rives, Boley, Jones & Grey, Boise, ID (on briefs), for defendant-appellant.

Ford Elsaesser (argued), Barbara Buchanan (on briefs), Elsaesser, Jarzabek, Buchanan and Dressel, Sandpoint, ID, for plaintiff-appellee.

Appeal from the United States District Court for the District of Idaho.

Before: WRIGHT, CANBY, and REINHARDT, Circuit Judges.

REINHARDT, Circuit Judge:

This case requires us to decide whether the new value "exception" to the absolute priority rule survives the enactment of the Bankruptcy Reform Act of 1978 (better known as the Bankruptcy Code), which replaced the Bankruptcy Act of 1898.¹ The new value exception allows the shareholders of a corporation in bankruptcy to obtain an interest in the reorganized debtor in exchange for new capital contributions over the objections of a class of creditors that has not received full payment on its claims. Whether this doctrine is viable under the Bankruptcy Code has significant implications for the relative bargaining power of debtors and creditors in Chapter 11 cases. Although no circuit court has

¹ We place quotation marks around the term "exception" because the label is a misnomer that has lead to significant confusion. However, due to the term's common usage, we shall employ it on some occasions. On others we shall use the more descriptive new value "doctrine" or "principle".

taken a definitive position on this question, dicta in several opinions demonstrate intra and inter-circuit disagreements. District and bankruptcy courts are sharply divided on the question, as are the commentators. The question will in all probability ultimately be decided by the Supreme Court. In the meantime, we conclude that the new value exception remains a vital principle of bankruptcy law.

I. BACKGROUND

In 1984-85, Northtown Investments built Bonner Mall. The project was financed by a \$6.3 million loan, secured by the mall property, from First National Bank of North Idaho, which later sold the note and deed of trust to appellant U.S. Bancorp Mortgage Co. ("Bancorp"). In October 1986 the mall was purchased by appellee Bonner Mall Partnership ("Bonner"), subject to the lien acquired

by Bancorp. Bonner is composed of six partners, five trusts and one individual investor, and was formed for the express purpose of buying the mall. Unfortunately, the cash-flow from the mall was much smaller than Bonner expected. When Bonner failed to pay its real estate taxes to Bonner County, Idaho, Bancorp commenced a nonjudicial foreclosure action. After several unsuccessful attempts to renegotiate and restructure Bonner's debt, Bancorp set a trustee's sale for March 14, 1991.

On March 13, 1991, Bonner filed a Chapter 11 (reorganization) bankruptcy petition, which automatically stayed the foreclosure sale. 11 U.S.C. § 362(a). Bancorp moved for relief from the stay under section 362(d)(2).² As a condition

² Bancorp also moved to dismiss the bankruptcy as a bad-faith filing. This motion was denied and no appeal has been taken.

to obtaining relief under that provision, Bancorp was required to show that Bonner had no equity in the mall and that Bancorp's claim against Bonner was undersecured. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 377 108 S.Ct. 626, 633, 98 L.Ed.2d 740 (1988). Because Bancorp established these facts, the burden shifted to Bonner to prove 1) that its retention of the mall was necessary to an effective reorganization,³ and 2) that there was a reasonable possibility of a successful reorganization within a reasonable time.⁴ See id. After two hearings on Bancorp's motion, the

³ The bankruptcy court found that this was shown.

⁴ In a § 362(d) proceeding the debtor need not demonstrate that its plan actually will be confirmed nor need it put forth the kind of evidence required at a confirmation hearing. See *John Hancock Mut. Life Ins. Co. v. Route 37 Business Park Assoc.*, 987 F.2d 154, 162 (3d Cir.1993). A debtor must, however, produce some evidence that its plan could be confirmed by a reasonable bankruptcy judge.

bankruptcy court denied it without prejudice. In his order denying relief the bankruptcy judge assumed the continued existence of the new value exception, noted its strict requirements, and expressed doubts whether Bonner could satisfy them. Nevertheless, he allowed Bonner thirty days to propose a plan.

Bonner filed a reorganization plan relying on the new value doctrine. In response Bancorp renewed its motion to lift the stay. Bancorp argued 1) that the new value exception did not survive the enactment of the Bankruptcy Code; and 2) even if it did, Bonner's plan was still unconfirmable as a matter of law. The parties stipulated that the motion involved only legal questions, so no evidence was taken. The bankruptcy court accepted Bancorp's first argument but did not reach the second. The bankruptcy judge noted that after his original order

the Fifth Circuit had concluded in its "convincing" decision in *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture* (*In re Greystone III Joint Venture*), 995 F.2d 1274 (5th Cir.1991), petition for rehearing granted in part and opinion withdrawn in part, 995 F.2d 1284 (5th Cir.) (*per curiam*), cert. denied, --- U.S. ----, 113 S.Ct. 72, 121 L.Ed.2d 37 (1992), that there is no longer a new value exception. On that basis, the judge granted Bancorp's motion for relief from the automatic stay. After the bankruptcy judge stayed his order at Bonner's request, Bonner appealed to the district court.

On appeal, the district judge determined that the only issue before him was whether the Bankruptcy Code had eliminated the new value exception. He found that it had not. In doing so he relied on the Supreme Court's ruling in

Dewsnup v. Timm, --- U.S. ----, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), which was handed down after the bankruptcy court's decision and which emphasized the Court's reluctance to overturn pre-Code practice (*see infra*). Moreover, by the time of the district court's opinion the relevant portion of the Fifth Circuit's *Greystone* opinion had been withdrawn.⁵ The district court reversed the judgment of the bankruptcy court and remanded for further proceedings consistent with its opinion. 142 B.R. 911. It refused to address Bancorp's alternative argument that Bonner's plan was unconfirmable as a matter of law even if the new value exception survived. Instead, its order stated: "Confirmation of the plan

⁵ On petition for rehearing and after the Supreme Court's decision in *Dewsnup*, the majority of the *Greystone* panel deleted the entire new value exception discussion over Judge Edith Jones' vigorous dissent. See 995 F.2d at 1285. The majority stated that it was expressing "no view whatever" on the new value exception. *Id.*

proposed by the Debtor must be addressed by the bankruptcy court on remand." Bancorp filed a timely appeal to this court. Like the district court, we resolve only the question whether the new value exception survives.⁶ The issue is one of law. Accordingly, our review is de novo. See *Home Sav. Bank, F.S.B. v. Gillam*, 952 F.2d 1152, 1156 (9th Cir.1991).

II. JURISDICTION

The parties agree that we have jurisdiction to hear Bancorp's appeal. Nevertheless, we have an independent duty to examine our own subject matter jurisdiction. *Pizza of Hawaii, Inc. v. Shakey's Inc. (In re Pizza of Hawaii, Inc.)*, 761 F.2d 1374, 1377 (9th Cir.1985). Twenty Eight U.S.C. section

⁶ For the reasons set forth in section V infra, we do not reach the question whether Bonner's plan can satisfy the requirements of the exception.

158(d) provides that "[t]he courts of appeal shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under subsections (a) and (b) of this section." Subsection (a) states in relevant part that: The district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees, and with leave of the court, from interlocutory orders, of bankruptcy judges entered in cases and proceedings referred to the bankruptcy judges under section 157 of this title. 28 U.S.C. § 158(a).⁷ For us to have jurisdiction, both the bankruptcy court's and district court's orders must be final. *Allen v. Old Nat'l Bank of Wash (In re Allen)*, 896 F.2d 416, 418 (9th Cir.1990) (per

⁷ The bankruptcy court had jurisdiction over Bancorp's motion under 28 U.S.C. §§ 157(b)(1) & (b)(2)(G). Therefore, the district court's appellate jurisdiction was properly invoked.

curiam). Here, the bankruptcy court's order granting relief from the automatic stay was clearly final.⁸ *Packerland Packing Co. v. Griffith Brokerage Co. (In re Kemble)*, 776 F.2d 802, 805 (9th Cir.1985). Moreover, if Bancorp had foreclosed on the mall, Bonner's sole significant asset, for all intents and purposes the bankruptcy case would have ended; therefore, the bankruptcy court's order required immediate appellate review. See *Elliot v. Four Seasons Properties (In re Frontier Properties, Inc.)*, 979 F.2d 1358, 1363 (9th Cir.1992); *Allen*, 896 F.2d at 418.

The more difficult question is whether the district court's order was

⁸ In his order granting Bonner a stay from his order lifting the automatic stay, the bankruptcy judge referred to his earlier action as interlocutory. That description is incorrect.

final.⁹ The unique nature of bankruptcy procedure dictates that we take a pragmatic approach to finality. *Vylene Enter. Inc. v. Naugles (In re Vylene Enter. Inc.)*, 968 F.2d 887, 894 (9th Cir.1992); *Mason v. Integrity Ins. Co. (In re Mason)*, 709 F.2d 1313, 1318 (9th Cir.1983). Our cases hold that 28 U.S.C. section 158(d) affords a more liberal finality standard than does 28 U.S.C.

* One noted commentator has described circuit law regarding the finality of intermediate level decisions in bankruptcy proceedings as "hopelessly unresolved." *1 Collier on Bankruptcy*, ¶ 3.03[6][b], 3-192 (Lawrence King, ed. 15th ed. 1992). The Third Circuit takes the view that where the bankruptcy court has issued an indisputably final order a district court decision affirming or reversing is also final because there is nothing further for the district court to do. *Official Unsecured Creditors Committee v. Michaels (In re Marin Motor Oil)*, 689 F.2d 445, 448-49 (3d Cir.1982), cert. denied, 459 U.S. 1207, 103 S.Ct. 1196, 75 L.Ed.2d 440 (1983). Other circuits adhere to a rule that a district court decision reversing and remanding is not final where the bankruptcy court will conduct significant further proceedings. E.g., *In re G.S.F. Corp.*, 938 F.2d 1467, 1472 (1st Cir.1991); *Suburban Bank of Cary Grove v. Riggsby (In re Riggsby)*, 745 F.2d 1153, 1155 (7th Cir.1984); *Homa v. Stone (In re Commercial Contractors, Inc.)*, 771 F.2d 1373, 1375 (10th Cir.1985). As discussed *infra* we have charted a middle-course between these positions.

section 1291.¹⁰ *Vylene*, 968 F.2d at 893-94.¹¹

Under Ninth Circuit law, if the district court affirms or reverses a final bankruptcy court order, its order is final. *King v. Stanton* (*In re Stanton*), 766 F.2d 1283, 1287 (9th Cir.1985). However, difficult questions

¹⁰ One of the reasons for this distinction is that by definition the decisions we review under § 158(d) are those of another court (whether a district court or a bankruptcy appellate panel) acting in an appellate capacity. In most situations a decision we review under § 1291 is that of a district court (or jury) sitting nisi prius as the factfinder. The rules of finality are designed, in part, to preserve the integrity of the factfinding process. This interest is not at stake in the case of an intermediate level decision in a bankruptcy proceeding. We review *de novo* all decisions of bankruptcy appellate panels and district courts in cases that come to us by way of § 158(d). See *Briggs v. Kent* (*In re Professional Inv. Properties of Am.*), 955 F.2d 623, 626 (9th Cir.), cert. denied, --- U.S. ----, 113 S.Ct. 63, 121 L.Ed.2d 31 (1992).

¹¹ In *Vylene* we raised the possibility that our decisions which hold that the finality requirements of § 1291 in the bankruptcy context are more stringent than those imposed by § 158(d) might be inconsistent with the "implications" of *Connecticut Nat. Bank v. Germain*, --- U.S. ----, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992). See 968 F.2d at 891-94. We need not address that question here except to note that nothing in *Germain* casts doubt upon the liberal standard for finality we have adopted regarding § 158(d).

regarding finality sometimes arise when a district court reverses a final order of a bankruptcy court and remands. *Vylene*, 968 F.2d at 895. In such circumstances we balance two important policies: avoiding piecemeal appeals and enhancing judicial efficiency. *Id.*; *Zolg v. Kelly* (*In re Kelly*), 841 F.2d 908, 911 (9th Cir.1988). We also consider the systemic

interest in preserving the bankruptcy court's role as the finder of fact. *Stanton*, 766 F.2d at 1287.¹² On the basis of our analysis of these factors, we have concluded that when the district court remands for further factual findings related to a central issue

¹² We have also considered whether delaying review might cause irreparable harm to a substantive right of the party that lost in the district court. E.g., *Vylene*, 968 F.2d 895-96. Delayed review in this case, however, would not cause irreparable harm to Bancorp; it would face only the prospect of unnecessarily litigating the merits of Bonner's reorganization plan in the bankruptcy court. See *Frontier Properties*, 979 F.2d at 1363 (impact upon litigation strategy and necessity of additional litigation are not irreparable harms).

raised on appeal, its order is ordinarily not final and we lack jurisdiction. *Id.* at 1286.

However, *Stanton* suggests that we should assert jurisdiction even though a district court has remanded a matter for factual findings on a central issue if that issue is legal in nature and its resolution either 1) could dispose of the case or proceeding and obviate the need for factfinding;¹³ or 2) would materially aid the bankruptcy court in reaching its disposition on remand. 766 F.2d at 1288 n. 8; see also *Farm Credit Bank of Spokane v. Fowler (In re Fowler)*,

¹³ In *Stanton* we imprecisely used the word "would" rather than "could" in the foregoing clause and thereby implied that we should assert jurisdiction under this exception only if we knew that our decision on the merits would obviate the need for further factfinding. Ordinarily, we must resolve the question of our jurisdiction before determining the merits of a case. Therefore, the *Stanton* suggestion applies where a decision in favor of one of the parties as to a central legal issue in the case would eliminate the necessity of factual findings on remand, regardless of our eventual ruling.

903 F.2d 694, 696 (9th Cir.1990) (citing second *Stanton* criterion with approval). We believe that the *Stanton* principle is sound and we adopt it here. The present case falls squarely within the first *Stanton* criterion. The central question is a legal one that is clearly potentially dispositive. It involves the very existence of the rule pursuant to which the bankruptcy court would be required to make factual findings on remand. If we hold that the new value exception no longer exists, no further factual proceedings will be necessary and Bancorp will be entitled to the relief it seeks as a matter of law.

The instant case presents a situation analogous to the one we faced in *Pizza of Hawaii*, which was cited with approval in *Stanton* and *Fowler*. In *Pizza of Hawaii* the bankruptcy court confirmed *Pizza's* proposed plan (a final order)

over Shakey's objection that the plan did not make sufficient provision for a debt that Pizza might owe Shakey's on account of a pending civil case. On appeal, the district court 1) vacated the order of confirmation; 2) ordered the bankruptcy court to grant Shakey's leave to amend its proof of claim; 3) ordered the bankruptcy court to value the claim; and 4) ordered the bankruptcy court to reconsider the plan's feasibility in light of the value of Shakey's claim. 761 F.2d at 1376. Pizza appealed the order to this court. Despite the fact that the district court had remanded for proceedings of a factual nature, we held that we had jurisdiction. 761 F.2d at 1378, 1382. Here, as in *Pizza of Hawaii*, the policy of judicial economy, which militates in favor of our asserting jurisdiction, strongly outweighs the need to avoid piecemeal appeals.

For the above reasons, we conclude that we have subject matter jurisdiction over Bancorp's appeal under 28 U.S.C. section 158(d).

III. BONNER'S PLAN, CONFIRMATION, AND THE NEW VALUE EXCEPTION

Bonner's proposed reorganization plan ("the Plan") provides for the transfer of all of Bonner Mall Partnership's assets (the mall for all practical purposes) to a new corporation, Bonner Mall Properties, Inc., created by the Plan to carry out its provisions. One of the most significant features of the Plan is the treatment of Bancorp's \$6.6 million claim, for which the mall is collateral. In the course of his original order denying Bancorp's motion for relief from the stay, the bankruptcy judge valued the mall at \$3.2 million. This meant that Bancorp's claim against Bonner was undersecured: it was secured

as to \$3.2 million and unsecured as to \$3.4 million. See 11 U.S.C. § 506(a). The unsecured portion of Bancorp's claim represents the vast majority of Bonner's unsecured debt. Under the Plan, the \$3.2 million debt to Bancorp secured by the mall would be paid 32 months after the Plan's confirmation, with interest payments payable monthly in the interim. Payment of all other secured debt would be deferred. All unsecured creditors of Bonner who are owed more than \$1000 would be paid according to a pro-rata distribution of 300,000 shares of preferred stock in the new corporation. Each share would be valued at \$1.00.¹⁴ The preferred stock would be convertible to a maximum of 300,000 shares of common

stock once Bonner paid off the secured part of Bancorp's claim.

Under the Plan the equity owners, i.e. the partners, would receive nothing on their claims. However, to raise additional capital for the new corporation, the partners would contribute a total of \$200,000 in cash to Bonner Mall Properties in exchange for 2 million of the 4 million authorized shares of the new corporation's common stock. No other persons are designated to receive stock in exchange for such contributions. The Plan also states that the partners would subsidize any shortfall in working capital during the first 32 months after confirmation of the plan.¹⁵ Moreover, the trustee for the five trust-partners of Bonner Mall Partnership is to contribute a collateral

¹⁴ Thus, Bancorp would receive less than ten cents on the dollar in preferred stock for its unsecured claim.

¹⁵ Bancorp questions whether this is a binding obligation under the terms of the plan.

trust mortgage on a 4500-acre property as a guarantee of payment of the debts assumed by Bonner Mall Properties.¹⁶ In exchange, the new corporation is to service part of the trustee's debt on the property.

Section 1129(a) of Chapter 11 establishes thirteen requirements for confirmation of a reorganization plan, all of which must generally be satisfied. One such requirement is set forth in subsection (a)(8), which mandates that "[w]ith respect to each class [of claims], A) such class has voted to accept the plan or B) such class is not impaired under the plan." 11 U.S.C. § 1129(a)(8).¹⁷ Under Bonner's Plan all

¹⁶ Bonner claims the property's fair market value is \$4.5 million, with equity of approximately \$2 million. These figures are disputed. Bancorp states that the property is the subject of a state court foreclosure proceeding.

¹⁷ A class is deemed to have accepted a plan if at least two-thirds in amount and more than (continued...)

claim classes are impaired and, therefore, all must accept the plan for a consensual confirmation. It is a foregone conclusion that at least the unsecured class of which Bancorp is the principal member will vote not to confirm the plan in view of the minimal return Bancorp will receive on the unsecured fraction of its claim.

However, the Code provides that where all requirements for confirmation but section 1129(a)(8) are met, the bankruptcy court shall confirm a Chapter 11 reorganization plan over the objection of an impaired class or classes "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is

¹⁷(...continued)
one-half in number of claims in the class vote to accept it. § 1126(c). A class is impaired if the plan does not provide it with full payment in cash of its claims on the date the plan becomes effective. § 1124(3)(A).

impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1) (emphasis added). This form of confirmation is commonly known in bankruptcy parlance as a "cramdown" because the plan is crammed down the throats of the objecting class(es) of creditors. The issue before the bankruptcy judge in deciding whether to grant Bancorp's motion for relief from the stay was whether Bonner's Plan had a reasonable possibility of confirmation in a cramdown, i.e., whether the standards set forth in section 1129(b)(1) could feasibly be satisfied.

The resolution of this question turns on whether there is a reasonable possibility that a bankruptcy judge could find Bonner's Plan "fair and equitable." Section 1129(b)(2) of the Code defines "fair and equitable" as including several enumerated requirements. The section, which is at the heart of the controversy

between the parties, states, *inter alia*, that a plan will be considered "fair and equitable" only if: (B) With respect to a class of unsecured claims-- (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property. (emphasis added). Section 1129(b)(2)(B) is a two-part codification of the judge-made absolute priority rule, compliance with which was a prerequisite to any determination that a plan was "fair and equitable" under the Bankruptcy Act.

Here, each of the unsecured claims against Bonner will not be paid in full

on the effective date of the Plan. As a result, section 1129(b)(2)(B)(i) cannot be satisfied. Therefore, Bonner's Plan cannot be held to be "fair and equitable" unless it complies with the provisions of section 1129(b)(2)(B)(ii). If it fails to meet the requirements of that section it is unconfirmable as a matter of law. A critical area of dispute in this case is whether Bonner's Plan violates section 1129(b)(2)(B)(ii) and, in turn, the absolute priority rule and the "fair and equitable" principle.

Under pre-Code Bankruptcy Act practice, a plan that allowed stockholders in the business that had filed for bankruptcy protection (old equity) to receive stock in the reorganized debtor in exchange for contributions of added capital (new value) could under certain conditions satisfy the absolute priority rule and be

considered "fair and equitable" even though a senior class was not paid in full. *See Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 121, 60 S.Ct. 1, 10, 84 L.Ed. 110 (1939); *Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, 317 U.S. 78, 85-86, 63 S.Ct. 93, 97-98, 87 L.Ed. 64 (1942); *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-43, 66 S.Ct. 290, 292-93, 90 L.Ed. 287 (1946). That set of conditions became known collectively as the "new value exception" to the absolute priority rule; the terms of that "exception" will be discussed below.

Although the question we must ultimately answer is whether the new value exception survived the enactment of the Bankruptcy Code, we should note, preliminarily, that the term "exception" is misleading. The doctrine is not

actually an exception to the absolute priority rule but is rather a corollary principle, or, more simply a description of the limitations of the rule itself. It is, as indicated above, the set of conditions under which former shareholders may lawfully obtain a priority interest in the reorganized venture. The Supreme Court appeared to recognize as much in *Case v. Los Angeles Lumber* when it stated that if a new capital contribution satisfies certain conditions "the creditor cannot complain that he is not accorded full right of priority against the corporate assets." 308 U.S. at 122, 60 S.Ct. at 10 (internal quotation omitted). More properly, the new value exception should be called something like the "new capital-infusion doctrine" or as one commentator has suggested, "the scrutinize old equity participation rule." Elizabeth Warren,

A Theory of Absolute Priority, 1991 Annual Survey of American Law 9, 42.

The question whether the adoption of the Code served to eliminate the new value exception was before the Supreme Court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988). While there is language in the opinion questioning the viability of the doctrine, the Court explicitly stated that it was not deciding the issue.¹⁹ Instead, the Court assumed that the doctrine existed but found that all of its requirements were not satisfied under the facts of that case. Since *Ahlers*²⁰ several court of

¹⁹ "Our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber* exception." *Norwest Bank v. Ahlers*, 485 U.S. at 203 n. 3, 108 S.Ct. at 967 n. 3. The Solicitor General had filed an amicus brief asking the Court to rule that the new value exception was defunct. *Id.*

²⁰ Prior to *Ahlers* the Sixth and Seventh Circuits both applied the new value exception in confirming reorganization plans in cases arising (continued...)

appeals have avoided a direct holding on the viability of the "exception" by using the same stratagem.²⁰

Other appellate courts have given mixed signals on whether the principle survives. The Seventh Circuit seems internally divided on the question: In one case it analyzed a reorganization plan in light of the exception, while stating that the status of the doctrine is an open question after Ahlers; another

²⁰(...continued)
under the Code. *Teamsters Nat. Freight Indus. Negotiating Comm. v. U.S. Truck Co.* (*In re U.S. Truck Co.*), 800 F.2d. 581, 588 (6th Cir.1986); *Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc.* (*In re Potter Material Serv., Inc.*), 781 F.2d. 99, 101 (7th Cir.1986). These opinions appear to have assumed the vitality of the doctrine without explicitly addressing the issue. While the Seventh Circuit's later jurisprudence in this area is confused (*see infra*), the Sixth Circuit has never questioned the viability of *U.S. Truck*. Indeed, bankruptcy courts of the Sixth Circuit have adhered to *U.S. Truck* as controlling precedent since Ahlers. See e.g., *In re Montgomery Court Apartments, Ltd.*, 141 B.R. 324, 343 (Bankr. S.D.Ohio 1992); *In re Professional Dev. Corp.*, 133 B.R. 425, 428 (Bankr.W.D.Tenn.1991).

²¹ E.g., *Unruh v. Rushville State Bank of Rushville, Mo.*, 987 F.2d 1506 (10th Cir.1993); *Anderson v. Farm Credit Bank of St. Paul* (*In re Anderson*), 913 F.2d 530 (8th Cir.1990).

panel criticized the exception and strongly hinted that it is moribund; and a third stopped just short of holding that the exception survives.²¹ The Fourth Circuit has suggested that if the new value exception exists it is narrow in scope.²² Our own Bankruptcy Appellate Panel has recognized the continued existence of the exception. See *Carson Nugget, Inc. v. Green* (*In re Green*), 98 B.R. 981, 982 (BAP 1989) (per curiam).

While there is a division in the district and bankruptcy courts of our circuit and nationwide, the majority of courts that have considered the question have held that the new value exception is

²² See *In re Stegall*, 865 F.2d 140, 141-44 (7th Cir.1989); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1359-62 (7th Cir.1990); *Snyder v. Farm Credit Bank of St. Louis* (*In re Snyder*), 967 F.2d 1126, 1128 (7th Cir.1992).

²³ *Travelers Ins. Co. v. Bryson Properties, XVIII*, (*In re Bryson Properties, Inc., XVIII*), 961 F.2d. 496, 503-05 (4th Cir.), cert. denied, --- U.S. ----, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992).

alive and well. We share the view that the doctrine remains a vital legal principle. Accordingly, we hold that the Code permits the confirmation of a reorganization plan that provides for the infusion of capital by the shareholders of the bankrupt corporation in exchange for stock if the plan meets the conditions that plans were required to meet prior to the Code's adoption.

IV. THE NEW VALUE EXCEPTION AND THE CODE

Our explanation of why we hold that the new value exception survives will address several distinct but related issues. First, we determine that the Code provision codifying the absolute priority rule does not prohibit confirmation of a new value plan.

Second, we decide that Congress' failure expressly to include the new value doctrine as a standard to be considered in applying the "fair and equitable"

principle does not reflect an intent to eliminate the exception. Finally, we conclude that the new value exception is fully consistent with the structure and underlying policies of Chapter 11.

A. The Codification of the Absolute Priority Rule Does Not Serve to Eliminate the New Value Exception.

The parties take diametrically opposed positions as to the consistency of the new value exception with 11 U.S.C. section 1129(b)(2)(B)(ii). Bancorp argues that: 1) Bonner's Plan violates the absolute priority rule because the old equity owners will have an ownership interest in the new company even though Bancorp's unsecured claim will not be paid in full and 2) the plain meaning of 11 U.S.C. section 1129(b)(2)(B)(ii) demonstrates that the new value exception did not survive the enactment of the Code. Bonner contends that: 1) the

infusion of new capital from a source outside the bankruptcy estate, even if the source is a former equity holder, is an independent act that does not violate the absolute priority rule and 2) section 1129(b)(2)(B)(ii) does not forbid confirmation of plans that meet the requirements of the new value exception.

In determining whether section 1129(b)(2)(B)(ii) abolishes the new value exception we apply the traditional tools of statutory construction. The interpretation of a statutory provision must begin with the plain meaning of its language. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 557, 110 S.Ct. 2126, 2130, 109 L.Ed.2d 588 (1990). Where statutory language is unambiguous the judicial inquiry is complete. *Connecticut Nat. Bank v. Germain*, --- U.S. ----, ----, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992).

It is a cardinal principle of statutory construction that a court must give effect, if possible, to every clause and word of a statute. *Negonsott v. Samuels*, --- U.S. ----, ----, 113 S.Ct. 1119, 1123, 122 L.Ed.2d 457 (1993). When the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language. *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 240-41, 109 S.Ct. 1026, 1029-30, 103 L.Ed.2d 290 (1988). Applying these familiar rules, we conclude that the plain language of section 1129(b)(2)(B)(ii) demonstrates that Bonner's, and not Bancorp's, reading of the provision is correct.

1. Because Qualifying New Value Plans Do Not Give Old Equity Holders Stock in the Reorganized Debtor "On Account Of" Their Prior Ownership

Interests, They Do Not Violate 11 U.S.C. Section 1129(b)(2)(B)(ii).

Eleven U.S.C. section 1129(b)(2)(B)(ii) requires that a plan provide that with respect to a class of unsecured claims that has not received full payment--

the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(emphasis added) In plainer English the provision bars old equity from receiving any property via a reorganization plan "on account of" its prior equitable ownership when all senior claim classes are not paid in full. E.g., *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1130 (7th Cir.1992); *Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (In re U.S. Truck Co.)*, 800 F.2d 581, 588

(6th Cir.1986); *Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)*, 147 B.R. 763, 768-69 (C.D.Cal.1992), appeal docketed, No. 93-55055 (9th Cir. Jan. 13, 1993); *In re Pullman Construction Indus.*, 107 B.R. 909, 944 (N.D.Ill.1989). The central inquiry in determining the reach of the prohibition is the meaning of the critical words "on account of".

We have no difficulty in reconciling the "on account of" language with the new value exception. Under Bankruptcy Act practice, old equity was required to meet several requirements in order to take advantage of that doctrine. Former equity owners were required to offer value that was 1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful reorganization and 5) reasonably equivalent to the value or interest received. *Case v. Los Angeles Lumber*, 308 U.S. at 121-22, 60 S.Ct. at

10-11; *Snyder*, 967 F.2d at 1131. Several courts have concluded that if a proposed plan satisfies all of these requirements, i.e. the new value exception, it will not violate section 1129(b)(2)(B)(ii) of the Code and the absolute priority rule.

Such a plan, they reason, will not give old equity property "on account of" prior interests, but instead will allow the former owners to participate in the reorganized debtor on account of a substantial, necessary, and fair new value contribution. *E.g., U.S. Truck*, 800 F.2d at 588; *The Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership* (*In re Woodscape Ltd. Partnership*), 134 B.R. 165, 168, 172-74 (Bankr.D.Md.1991). We agree with their analysis.

We recognize that in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are

former owners. But it is also true that in new value transactions old equity owners receive stock in exchange for the additional capital they invest.

Causation for any event has many and varied levels. Here, the answer to the meaning of the phrase "on account of" lies in the level of causation Congress had in mind when it prohibited old equity owners from receiving property "on account of" their prior interests. A reading of the full text of section 1129(b)(2)(B)(ii) makes it clear that what Congress had in mind was direct or immediate causation rather than a more remote variety, and that it did not intend to prohibit persons who receive stock because they have provided new capital from becoming participants in the reorganized debtor simply because they

were also owners of the original enterprise.²³

Had Congress intended that old equity never receive any property under a reorganization plan where senior claim classes are not paid in full, it could simply have omitted the "on account of" language from section 1129(b)(2)(B)(ii). We would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor in such circumstances. The expansive reading of the phrase "on account of such junior claim or interest" suggested by Bancorp would lead to the

²³ Professor Warren has stated: The Code does not prohibit old equity from becoming a post-petition financer of the business or a post-plan owner of the business. The Code leaves old equity in the same position as any other potential investor: it may offer to buy any of the assets of the estate on the same terms as any other buyer. *A Theory of Absolute Priority* at 39. Accord Raymond T. Nimmer, *Negotiating Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 Emory L.J. 1009, 1051 (1987); Bruce A. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan.L.Rev. 69, 96-102 (1991).

identical result, thus rendering the disputed phrase superfluous. Under that interpretation any distribution to old equity would always be "on account of" its former interest in some sense. We decline Bancorp's invitation to nullify Congress' deliberate use of the term "on account of such junior claim or interest", particularly since nearly identical language can be found throughout the Code.²⁴ Congress must have intended the "on account of" language to have some significant meaning as well as some particular limiting effect.

We believe that Congress intended the "on account of" phrase in section 1129(b)(2)(B)(ii) to require bankruptcy courts to determine whether a

²⁴ For example, section 1129 alone uses a variant of the "on account of such claim or interest" language seven times.

reorganization plan that gives stock to former equity holders does so primarily because of their old interests in the debtor or for legitimate business reasons. The new value doctrine provides the means by which a court can discover whether a particular new capital transaction is proposed "on account of" old equity's prior ownership or "on account of" its new contribution. In other words, in evaluating whether a reorganization plan satisfies the requirements of the new value exception a court is in fact determining whether old equity is unjustifiably attempting to retain its corporate ownership powers in violation of the absolute priority rule or whether there is genuine and fair exchange of new capital for an equity interest.

Contrary to Bancorp's contentions, section 1129(b)(2)(b)(ii) does not by its

terms eliminate, or even refer to, the new value exception.²⁵ Rather, the language of that section and the requirements of the new value principle complement each other. Consequently, the fact that a reorganization plan provides for a new value transaction does not in and of itself violate 11 U.S.C. section 1129(b)(2)(B)(ii) and the absolute priority rule.

2. The "On Account Of" Language of Section 1129(b)(2)(B)(ii) Does Not Bar Plans That Give Old Equity Alone the Opportunity to Acquire Stock for a New Capital Contribution.

²⁵ We agree with the Woodscape court that a textual search for a "new value exception" to the absolute priority rule dictates its own negative result because such a statutory exception does not exist. 134 B.R. at 173. As we have explained, the new value principle is an extra-statutory doctrine that specifically regulates the conditions under which plans calling for an infusion of capital by old equity in exchange for participation in the reorganized debtor may be confirmed in a cramdown. See also F.A.B., 147 B.R. at 768-69 (quoting amicus brief submitted by Professor Elizabeth Warren). A qualifying new value plan simply does not violate the absolute priority rule.

As Bancorp notes, several courts have held that where a reorganization plan gives old equity alone the right to obtain an interest in the reorganized debtor in exchange for new value, as Bonner's Plan does, the old equity holders are given "property" on account of their prior ownership interests and the absolute priority rule is violated. The Fourth Circuit held that such plans violate section 1129(b)(2)(B)(ii), even assuming the new value exception still exists. *Travelers Ins. Co. v. Bryson Properties, XVIII (In re Bryson Properties, XVIII)*, 961 F.2d 496, 504 (4th Cir.), cert. denied, --- U.S. ----, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992);²⁶

* In *Bryson* the Fourth Circuit seemed to find the fact that the debtor has the exclusive right to file a plan within 120 days of the order allowing it to proceed under Chapter 11 relevant to the validity of the plan under consideration. *Id.* at 504. The debtor receives this exclusive opportunity, which may be enlarged or shortened by the bankruptcy judge upon notice for cause, by operation of law. 11 U.S.C. § 1121(b)-(c). We do (continued...)

see also *In re A.V.B.I., Inc.*, 143 B.R. 738, 740-41 (Bankr.C.D.Cal.1992) (holding new value exception does not survive the Code); *In re Outlook/Century Ltd.*, 127 B.R. 650, 654 (Bankr.N.D.Cal.1991); *Lumber Exchange Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exchange Ltd. Partnership)*, 125 B.R. 1000, 1008 (Bankr.D.Minn.), aff'd, 134 B.R. 354 (D.Minn. 1991), aff'd, 968 F.2d 647 (8th Cir.1992). Under this analysis the "property" given to old equity in violation of the absolute priority rule is not the stock in the reorganized debtor received in exchange for a new

²⁶(...continued)

not believe that this exclusivity period, which did not exist under the Act, makes the new value exception objectionable under the Code. Any party in interest may file a plan 1) if the debtor has not done so within the 120 days; 2) or if that plan is not accepted within 180 days of the order for relief under Chapter 11. 11 U.S.C. § 1121(c). Any proposed reorganization plan may take advantage of the new value principle. Moreover, in this case Bonner filed its plan after the exclusivity period had expired. Therefore, Bancorp had the ability to propose a competing plan if it so desired.

value contribution. Rather "[the] exclusive right of [the] Debtor's existing partners to obtain equity interests in [the] Debtor itself constitutes property that the partners retain 'on account of' their existing interests." *Outlook/Century*, 127 B.R. at 654 (emphasis added).

We disagree with this analysis. Even assuming that an exclusive opportunity is "property,"²⁷ it does not follow that such an opportunity is property received or retained "on account of" old equity's prior ownership interests in the debtor. A proposed reorganization plan may give old equity

²⁷ The definition of "property" under the Code is extremely broad and includes intangible property. *Ahlers*, 485 U.S. at 208, 108 S.Ct. at 969. However, the exclusivity of the opportunity to purchase stock is irrelevant. Even if specified creditors and outside investors were given the opportunity to purchase stock for new value as well, old equity would still be given something of value which may be described as "property". A stock purchase option is property whether or not other people are also given such an option. See *Kham & Nate's Shoes*, 908 F.2d at 1360.

the exclusive opportunity to purchase stock in exchange for new capital for other reasons.²⁸ Exclusivity may be given because the plan proponent may believe that the participation of old equity in the new business will enhance the value of the business after reorganization. It is possible the debtor will conclude that additional funding will be easier to obtain if the old owners, the most likely investors, know in advance that their partners will all be familiar faces. Even more important, it may be apparent to the proponents of the plan that there will be no other legitimate investors who would be willing to put substantial capital into a business that is just emerging

²⁸ In theory, a reorganization plan could give the exclusive opportunity to receive stock in exchange for a new value contribution to anybody. For reasons that may sometimes be valid and sometimes not it will usually be the old owners.

from Chapter 11 protection.²⁹ As the Supreme Court has stated "[g]enerally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them." *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455, 46 S.Ct. 549, 522, 70 L.Ed. 1028 (1926); accord *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-43, 66 S.Ct. 290, 292-93, 90 L.Ed. 287 (1946) (new money may not be available unless there is a "strong inducement"). The proponent of a plan may have good reason to believe that old

²⁹ This situation may occur with greater frequency in cases, such as the present one, involving single asset commercial real estate bankruptcies. In many parts of the country a depressed commercial real estate market will make these investments unattractive.

equity would not participate without the incentive of an exclusive opportunity.

As stated earlier, whether a particular plan gives old equity a property interest "on account of" its old ownership interests in violation of the absolute priority rule or for another, permissible reason is a factual question. The answer depends upon whether the requirements of the new value exception are met. We believe that this same analysis applies whether a plan gives old equity an exclusive or non-exclusive right of participation in a new value transaction. What matters instead is whether the proposed transaction meets the criterion "necessary to the success of the reorganization".³⁰ In other

³⁰ *Case v. Los Angeles Lumber* does not require that old equity be the only source of new capital for its contribution to meet this test; it is enough that the prior stockholders be the "most feasible source of the new capital." See 308 U.S. at 121 n. 15, 60 S.Ct. at 10 n. 15 (internal quotation omitted).

words, if an exclusive participation plan satisfies that requirement, then it allows the partners the sole right to participate in a new value transaction not because of illegitimate collusion between old equity and the plan proponent but because such participation is necessary for a successful reorganization and in the best interests of all concerned. Of course, any exclusive participation plan must also fulfill the new value doctrine's four other requirements as well.

In sum, where the strictures of the new value exception are met, there is simply no violation of the absolute priority rule, whether the plan provides for exclusive or non-exclusive participation, because old equity will not retain or receive property "on account of" its old ownership interests

in violation of section 1129(b)(2)(B)(ii).

B. Congress' Failure to List the New Value Exception as a Specific Doctrine Permitted under the "Fair and Equitable" Principle Does Not Demonstrate an Intent to Eliminate It.

While the absolute priority rule clearly does not prohibit confirmation of a new value exception plan in a cramdown, this does not necessarily mean that the "fair and equitable" provisions of the Code should be interpreted as permitting confirmation of such a plan. Bancorp argues that Congress' failure expressly to provide for the continuation of the new value exception in the provision setting forth the requirements of the "fair and equitable" principle must be interpreted as an implicit statement that it did not intend the doctrine to survive the adoption of the Code. Recognizing that the Code does not unambiguously

allow for new capital contribution plans, Bonner argues that such plans are consistent with the "fair and equitable" principle and that despite the absence of an express provision, Congress intended to maintain the new value exception.

Bonner relies upon "the normal rule of statutory construction . . . that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic Nat'l. Bank v. New Jersey Dept. of Env'tl. Protection*, 474 U.S. 494, 501, 106 S.Ct. 755, 759, 88 L.Ed.2d 859 (1986) (citations omitted); *Kelly v. Robinson*, 479 U.S. 36, 47, 107 S.Ct. 353, 359, 93 L.Ed.2d 216 (1988). This rule is followed with particular care in construing the Bankruptcy Code. *Midlantic*, 474 U.S. at 501, 106 S.Ct. at 759. When Congress amends the bankruptcy laws, it does not start from scratch.

See *Dewsnup v. Timm*, --- U.S. ----, ----, 112 S.Ct. 773, 779 (1992). The Bankruptcy Code should not be read to abandon past bankruptcy practice absent a clear indication that Congress intended to do so. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 563, 110 S.Ct. 2126, 2133, 109 L.Ed.2d 588 (1990).³¹

At oral argument Bancorp suggested that the new value exception was mentioned once in dicta by the Supreme Court in *Case v. Los Angeles Lumber Products* and thereafter never heard from again. Consequently, Bancorp argues that

³¹ Bancorp argues that the *Midlantic/Kelly* rule of construction set forth above applies only where there is a conflict between bankruptcy law and non-bankruptcy law. While there is language in *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 245, 109 S.Ct. 1026, 1033, 103 L.Ed.2d 290 (1988), supporting such a narrow view of those cases, the later *Davenport* case gives a broader reading to the *Midlantic/Kelly* principle. *Davenport* applied the principle where there was no conflict with non-bankruptcy law. *Dewsnup*, an even later case, is consistent with *Davenport's* approach.

Congress would not have known of the principle when it enacted the Code. Cf. *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 246, 109 S.Ct. 1026, 1033, 103 L.Ed.2d 290 (1988) (practice of denying post-petition interest to holders of non-consensual liens was an exception to an exception practiced only by a few courts so Congress would not have known of it). We disagree.

There is simply no question that the new value exception was an established pre-Code Bankruptcy practice of which Congress would have had (and did have) knowledge. *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1129 (7th Cir.1992). First, several Supreme Court cases had mentioned the principle, albeit the last time in 1946. Second, several appellate court cases recognized the new value doctrine after 1946: E.g., *Phelan v. Middle States Oil*

Corp., 220 F.2d 593, 614 (2d Cir.), cert. denied, 349 U.S. 929, 75 S.Ct. 772, 99 L.Ed. 1260 (1955); *Security & Exch. Comm'n v. Canandaigua Enterp. Corp.*, 339 F.2d 14, 21 (2d Cir.1964). Finally, a proposal to broaden the new value exception was put before Congress during the drafting of the Code. While the proposal was rejected, that action demonstrates that Congress knew of the doctrine when it enacted the Code.

Once it has been shown that Congress was aware of a pre-Code practice, the remaining inquiry under *Dewsnup* and *Davenport* is whether it has made clear its intent to change that practice. Bancorp argues that the codification of the formerly judicially-defined concept of "fair and equitable" without a reference to the new value exception shows Congress' clear intent to eliminate

the doctrine.³² See *In re A.V.B.I., Inc.*, 143 B.R. 738, 743 (C.D.Cal.1992). However, section 1129(b)(2) explicitly defines the term "fair and equitable" as merely including the general requirements listed in the Code and expressly leaves room for additional factors to be considered in applying the principle in other particular circumstances. See 11 U.S.C. § 102(3) (defining "includes" as "not limiting"). There is nothing in the language of the Code that suggests that courts cannot continue to apply the requirements of the new value exception in determining whether a plan that affords old equity a property interest in exchange for a capital contribution is

³² The term "fair and equitable" originated in the field of equity receivership reorganizations. *Case v. Los Angeles Lumber*, 308 U.S. at 115, 60 S.Ct. at 6. The phrase was first codified in 1934 as section 77B(f)(1) of the Bankruptcy Act but given no statutory definition. Section 77B was repealed and replaced by Chapter X of the Bankruptcy Act in 1938.

"fair and equitable". See *Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc.* (*In re Potter Material Serv., Inc.*), 781 F.2d 99, 101-02 (7th Cir.1986). In any event, the text of section 1129(b)(2) does not evidence the clear intent necessary to support a conclusion that Congress decided to eliminate the new value doctrine; silence is not a sufficient basis from which we may infer such a purpose. See *Kelly*, 479 U.S. at 47, 107 S.Ct. at 359.

Where the text of the Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended it to continue unless the legislative history dictates a contrary result. See *Dewsnup*, --- U.S. at ----, 112 S.Ct. at 779. It does not do so here. If anything, the legislative history of the Code supports the

continued existence of the new value doctrine. It contains statements by sponsors of the Code that although section 1129(b)(2) lists several specific factors interpreting "fair and equitable", others were omitted to avoid statutory complexity and because courts would independently find that they were fundamental to "fair and equitable treatment".³³ See 124 Cong.Rec. 32407 (Sept. 28, 1978) (Statement of Rep. Don Edwards); 124 Cong.Rec. 34006 (Oct. 5, 1978) (statement of Senator Dennis DeConcini). This legislative history is evidence that Congress enacted the Code with knowledge that other, judicially-created standards governing the

³³ One example of a well-established component of "fair and equitable" that was not included was the concept that no senior class is to receive more than 100 percent of the amount of its claims. For a discussion of the uncodified aspects of the "fair and equitable" principle under the Bankruptcy Code, see Kenneth N. Klee, *Cram Down II* 64 Am.Bankr.L.J. 229 (1990).

application of the "fair and equitable" principle existed and that it failed to include such standards for reasons other than an intent to eliminate them.

As stated earlier, in enacting the Code Congress rejected a proposal by the Bankruptcy Commission to expand the new value exception significantly. See Victor Budney, *The Bankruptcy Commission's Proposed Modifications of the Absolute Priority Rule*, 48 Am.Bankr.L.J. 305, 335-36 (1974). That proposal would have eliminated the "money or money's worth" requirement set forth in *Case v. Los Angeles Lumber* and permitted new "important" contributions, including contributions of management, to suffice. Report of the Commission on the *Bankruptcy Laws of the United States*, H.R.Doc. No. 93- 137, 93d Cong., 1st Sess., pt. I, 258-59; pt. II, §§ 7-303(7), 7-310 (1973); *Norwest Bank*

Worthington v. Ahlers, 485 U.S. 197, 205-06, 108 S.Ct. 963, 968-69, 99 L.Ed.2d 169 (1988). Congress' rejection of the Bankruptcy Commission's proposal shows only that it did not want to broaden the exception; it does not indicate rejection of the exception itself. *Travelers Ins. Co. v. Bryson Properties*, XVIII, (*In re Bryson Properties, Inc.*, XVIII), 961 F.2d 496, 504 n. 13 (4th Cir.), cert. denied, --- U.S. ----, 113 S.Ct. 191, 121 L.Ed.2d 134 (1992). Indeed, "the Commission's proposal presupposed the existence of the new value exception, and Congress's rejection of the modification could just as easily be construed as an endorsement of the status quo." *Snyder*, 967 F.2d at 1130.

In sum, neither the text nor the legislative history of section 1129(b)(2) justifies the conclusion that the new

value exception was eliminated. See *Bryson*, 961 F.2d at 504 n. 13. Congress' failure to include explicitly the well-established requirements of the new value exception in section 1129(b)(2) is of no assistance to Bancorp. Given that there is no evidence of a clear intent on the part of Congress to eliminate the new value exception in either the statutory text or the legislative history, under *Dewsnup* and *Davenport* pre-Code practice continues to apply.

C. Congress' Overhaul of the Reorganization Process Does Not Justify a Conclusion that the New Value Exception was Abolished.

Bancorp contends that where the Code totally revamps an area of bankruptcy law, pre-Code practice may appropriately be ignored. Bancorp relies on *Union Bank v. Wolas*, --- U.S. ----, 112 S.Ct. 528, 116 L.Ed.2d 514 (1992), in support of this proposition. In *Wolas* the Court

unanimously found that the text of the Code sharply limited the pre-Code practice at issue. Under the Bankruptcy Act a trustee could avoid a debtor's payments on a long-term debt if they were made during the ninety days prior to bankruptcy. However, he could not avoid such payments made on current expenses. In contrast, section 547(c)(2) of the Code states that a trustee cannot avoid payments made during the prescribed period if they were in the "ordinary course of [the debtor's] business or financial affairs". The Court found that the plain meaning of this Code section circumscribed the trustee's pre-Code avoidance powers with respect to long term debt. --- U.S. ----, 112 S.Ct. at 530. While the *Wolas* Court relied in part upon the major changes made to the statutory framework by the enactment of the Code, it did so only as a

confirmation of its earlier conclusion that the plain text of the Code provision altered pre-Code practice. --- U.S. at ----, ----, 112 S.Ct. at 530, 532. Here, and as shown above, the language of the text at issue, section 1129(b)(2), does not by its terms affect the new value exception in any respect.

Bancorp next argues that the changes made to the reorganization process were more drastic than those at issue in *Wolas* and therefore pre-Code practice should be discarded. As Bancorp notes, under the Bankruptcy Act there were two reorganization chapters, X (publicly held companies) and XI (privately held companies), which varied in certain important respects.³⁴ On the one hand, Congress' combining them into a single

³⁴ For example, Chapter X had an absolute priority rule; Chapter XI did not. Trustees were mandatory in Chapter X cases; the debtor retained control under Chapter XI.

reorganization chapter was a significant Code innovation. See A.V.B.I., 143 B.R. at 747. On the other hand, the new Chapter 11 shifted bargaining power away from creditors and in favor of debtors. Consequently, it made plan confirmation easier. While it might be, as Bancorp argues, that the new value exception is not as necessary under the current regime, see also *In re Outlook/Century Ltd.*, 127 B.R. 650, 657 (Bankr.N.D.Cal.1991), we believe that the structural changes to the reorganization process made by the Code are in harmony with the pro-confirmation principle underlying the new value exception. Accordingly, these changes cannot carry Bancorp's argument that the new value doctrine is no longer viable.

Specifically, Bancorp recounts that under the Act voting on the confirmation of a plan was by individual creditors

rather than by classes of creditors, as is the case under the Code.³³ It contends that the new value exception was designed merely to prevent one dissenting creditor from preventing confirmation. See *Lumber Exchange Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exchange Ltd. Partnership)*, 125 B.R. 1000, 1007 & n. 10 (Bankr.D.Minn.), aff'd 134 B.R. 354 (D.Minn.1991), aff'd 968 F.2d 647 (8th Cir.1992). However, there is no significant difference between the problem that a holdout class poses for confirmation and that posed by a holdout creditor. *Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership)*, 134 B.R. 165, 168, 171 (Bankr.D.Md.1991). While Bancorp assumes that the new value exception was intended

³³ Creditors are given guarantees as individual creditors under the best interests test. 11 U.S.C. § 1129(a)(7).

to solve a no longer existent individual holdout problem, it could just as logically be argued that the new value exception was designed to prevent confirmation holdouts, individual or class, from derailing an otherwise "fair and equitable" plan. See *In re Pullman Construction Indus.*, 107 B.R. 909, 944-45 (Bankr.N.D.Ill.1990). From this perspective, the rationale for the new value exception is as applicable today as it ever was, and there is no reason for us to view it as defunct.

Bancorp also contends that the Code meant to give creditors, not the bankruptcy court, the power to decide when to waive the absolute priority rule. See *Kham & Nate's Shoes No. 2 v. First Bank*, 908 F.2d 1351, 1360 (7th Cir.1990) (creditors effectively own bankrupt firms and they should decide whether old equity should participate). It is true that 11

U.S.C. section 1126(c) allows creditors to consent to confirmation of a plan that does not comply with the absolute priority rule. However, that section permits creditors to waive a priority they possess. The new value exception allows bankruptcy courts to afford a priority to others over the creditors. There is simply no logical analysis that would allow us to conclude that by permitting creditors to waive their own priority Congress demonstrated the intent to deprive bankruptcy courts of their power to afford investors of new capital a priority over an impaired class of creditors. Moreover, the very purpose of the Code's cramdown provision, section 1129(b), which had no direct equivalent under the Act, is to allow the court, and not the creditors, to decide whether a "fair and equitable" plan should be confirmed over creditor objections.

While creditor autonomy is certainly an important aspect of the reorganization process, the argument that the new value exception impedes that autonomy is really a complaint against the practice of confirmation by cramdown. That grievance cannot be addressed here.

Finally, Bancorp argues that the Code's creation of the entity of the debtor-in-possession to run the business in lieu of a trustee would cause self-dealing by insiders if the new value exception were still allowed. See A.V.B.I., 143 B.R. at 743. However, the very purpose of the Code's creation of the debtor-in-possession was to increase the power of those in control of the debtor during the reorganization process. Bankruptcy law is very formalistic in that it treats the debtor, the debtor-in-possession, and old equity as legally distinct entities when in reality they

may all be one and the same. See, e.g., *In re Kendavis Industries Int'l, Inc.*, 91 B.R. 742, 751, 754 (N.D.Tex.1988) (law firm has conflict of interest in representing both the debtor and equity in bankruptcy proceeding); *In re Rusty Jones, Inc.*, 134 B.R. 321, 343 (Bankr.N.D.Ill.1991) (same).

The risk of self-dealing among these entities at the expense of creditors is a risk created by the Code itself. The stringent requirements of the new value exception are designed to mitigate that risk. The enactment in the Code of changes that aggravate the self-dealing problem constitutes good reason for courts to make certain that a proposed new value plan strictly adheres to the requirements of the exception. The modifications to the reorganization process are not, however, cause for us to ignore several decades of bankruptcy

practice in determining Congress' intent with respect to the new value exception.

Despite all of the differences between the Act and the Code, the primary rationale for the new value exception has not been eliminated by any statutory alteration to the confirmation process.

The new value exception is based on "practical necessit[y]", on the recognition that new money frequently could not be obtained for the reorganized debtor in the absence of that doctrine.

See Mason v. Paradise Irrigation Dist., 326 U.S. 536, 542, 66 S.Ct. 290, 292 (1946); *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455, 46 S.Ct. 549, 551 (1926). That practical necessity remains just as pertinent under the Code. Where the main justification for a long-term judicially sanctioned practice has not dissipated, either through a change in conditions or

by way of legislative amendment, there is simply no reason to disregard the practice absent a clear legislative intent to abolish it. Bancorp's structural-change arguments simply do not convince us that pre-Code practice should be ignored in this case.

D. The New Value Exception is Consistent with the Underlying Policies of Chapter 11.

In interpreting statutory language we are not confined to the specific provision at issue but may look to the structure of the law as a whole and to its object and policy. *Patterson v. Shumate*, --- U.S. ----, ---- - ----, 112 S.Ct. 2242, 2246-47, 119 L.Ed.2d 519 (1992); *Kelly v. Robinson*, 479 U.S. 36, 43, 107 S.Ct. 353 (1986). Chapter 11 has two major objectives 1) to permit successful rehabilitation of debtors (*NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 527, 104 S.Ct. 1188, 1196, 79

L.Ed.2d 482 (1984)); and 2) to maximize the value of the estate (*Toibb v. Radloff*, --- U.S. ----, ----, 111 S.Ct. 2197, 2201, 115 L.Ed.2d 145 (1991)). The new value exception, properly applied, serves both goals. By permitting prior stockholders to contribute new money in exchange for participation in the reorganized company, the debtor is given an additional source of capital. The new contribution increases the amount available for the estate to use both in its reorganization and in funding the plan and paying creditors. Without the inducement of participation in the reorganized debtor, the new money may be unavailable. *Mason v. Paradise Irrigation*, 326 U.S. at 542, 66 S.Ct. at 292. All parties involved, including the creditors, benefit from an increase in the assets of the estate.

"Prior owners are a source of capital different in kind from new investors in that they have an ongoing role in the reorganization and a prior investment in the company." *Prudential Ins. Co. v. F.A.B. Indus. (In re F.A.B. Indus.)*, 147 B.R. 763, 769 n. 13 (C.D.Cal.1992) (quoting Nimmer, *supra* note 23, at 1050), appeal docketed, No. 93-55055 (9th Cir. Jan. 13, 1993). Moreover, in many situations the new value exception allows control and management of the company to remain with the original owners, who arguably can best reestablish a profitable business. Old owners may have valuable expertise and experience that outside investors lack. *Snyder v. Farm Credit Bank of St. Louis (In re Snyder)*, 967 F.2d 1126, 1130 (7th Cir.1992). Some studies demonstrate that reorganizations have been more successful when former

management was allowed to use its expertise in running the business.

Harvey Miller, Commentary on Absolute Priority, 1991 Annual Survey of American Law 49, 50.

It has been argued that the new value exception allows old equity to repurchase the business at a bargain price, while superior creditors go unpaid, and that this result is contrary to the Chapter 11 policy of protecting creditor interests. See, e.g., A.V.B.I., 143 B.R. at 747. We believe that this argument is incorrect in two respects. First, while the protection of creditors' interests is an important purpose under Chapter 11,³⁶ the Supreme Court has made clear that successful debtor reorganization and maximization of the

* For example, a Chapter 11 plan cannot be confirmed unless the court finds that creditors will receive under it at least as much as they would in a liquidation. § 1129(a)(7).

value of the estate are the primary purposes.³⁷ See *Bildisco*, 465 U.S. at 527, 104 S.Ct. at 1196; *Toibb v. Radloff*, --- U.S. ----, 111 S.Ct. at 2201.

Chapter 11 is designed to avoid liquidations under Chapter 7, since liquidations may have a negative impact on jobs, suppliers of the business, and the economy as a whole. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203, 103 S.Ct. 2309, 2312, 76 L.Ed.2d 515 (1983). The ability of stockholders to remain in possession and control of operations, rehabilitate the business, and retain ownership through the new value exception encourages debtors to attempt Chapter 11 reorganization instead of simply

³⁷ From one perspective, the debate over the survival of the new value exception is a division between those who perceive the paramount objective of Chapter 11 to be successful reorganization of the debtor and those who believe it should be protection of creditors' interests.

liquidating their assets and starting over.

Second, we believe that if the new value exception's requirements are properly applied, creditors' interests will generally be benefited as well. The strictures of the new value doctrine provide creditors with significant safeguards against collusion between the proponent of the reorganization plan and the old equity owners.³⁸ Although the new value exception has been criticized as a subversion of the absolute priority rule, its requirements actually enhance the rule. As we noted earlier, they constitute guidelines by which a court can ensure that old equity will not acquire an interest in the reorganized debtor or other property on account of

* If old equity contributes a substantial amount of new capital to the business undergoing reorganization, then the risk of a later failure falls more heavily on stockholders than creditors. See Nimmer, *supra* note 23, at 1050-52, 1072-73.

its old ownership interests. In fact, the new value exception puts limits on the power of old equity to gain an interest in the reorganized business beyond that provided in the explicit language of the Code. For example, there is nothing in the text of the Code that prevents stockholders from obtaining property in the reorganized debtor in exchange for contributions of labor; such a transaction would not give old equity any property "on account of" its prior ownership interests. Yet the requirements of the new value exception prohibit this type of transaction. See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 204-06, 108 S.Ct. 963, 967-69, 99 L.Ed.2d 169 (1988) (contributions must be money or money's worth).³⁹

* See also *In re Stegall*, 865 F.2d 140, 142-44 (7th Cir.1990) (the contribution of one hundred pigs among other farm related items of unknown value does not satisfy the new value exception).

As long as courts carefully apply the new value exception, it will not operate as a mechanism by which old equity can escape the requirements of the absolute priority rule. If a plan meets all the requirements of the new exception, it may be confirmed in a cramdown, assuming all other conditions for confirmation are present. Within the confines of the Code, bankruptcy courts are courts of equity. *Ahlers*, 485 U.S. at 206, 108 S.Ct. at 968. Properly applied, the new value exception allows bankruptcy courts to fulfill their assigned role of balancing the interests of debtors, creditors, old owners, and the public, guided by the overriding goal of ensuring the success of the reorganization. See *Pioneer Inv. Serv. v. Brunswick Assoc.*, --- U.S. ----, 113 S.Ct. 1489, 1495, 123 L.Ed.2d 74 (1993).

Thus, our conclusion that nothing in the Bankruptcy Code forbids the confirmation of plans that comply with the new value doctrine is entirely consistent with Congressional bankruptcy policy. Because our reading of the statute will not produce results demonstrably at odds with the intentions of its drafters, we must enforce the Code according to its terms. *United States v. Ron Pair Enterp., Inc.*, 489 U.S. 235, 242, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1988). Therefore, Bonner's Plan is not unconfirmable simply because it provides for a new value transaction.

V. THE NEW VALUE EXCEPTION AND THE BANCORP'S MOTION FOR RELIEF FROM THE AUTOMATIC STAY

As noted above, the precise issue posed by Bancorp's motion for relief from stay is not whether Bonner's plan will ultimately be confirmed under section 1129 but whether there is a reasonable

possibility that it can be confirmed within a reasonable time. That is all that Bonner need show to defeat Bancorp's section 362(d)(2) motion. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 376, 108 S.Ct. 626, 633, 98 L.Ed.2d 740 (1988). It need not put forth evidence of the type it would be required to produce in a confirmation hearing. See *John Hancock Mutual Life Ins. Co. v. Route 37 Business Park Assoc.*, 987 F.2d 154, 162 (3d Cir.1993).

Bancorp correctly argues that if Bonner's Plan cannot possibly satisfy all of the requirements of the new value exception it cannot be confirmed as a matter of law and relief from the stay must be granted. While it is true that in certain cases an appellate court can determine the feasibility of confirmation as a matter of law, see *id.*, because of

the lack of a sufficient factual record we cannot do so here. The bankruptcy court never held a hearing on the feasibility of the confirmation of Bonner's plan and the district court failed to reach the issue as well. On this record we cannot say as a matter of law that Bonner's proposed Plan cannot satisfy all of the requirements of the new value exception.⁴⁰ A remand to the bankruptcy court is required to determine the feasibility of confirmation and whether, despite the survival of the new value exception, Bancorp's motion for

⁴⁰ Courts and commentators have noted certain conceptual difficulties regarding valuation inherent in the application of the new value exception. E.g., *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1008-10 (Bankr.D.Mass.1991); *Markell*, *supra* note 23, at 119-21. While we are aware that valuation can be complicated and uncertain in this context, as well as in bankruptcy generally, see, e.g., *Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc.* (*In re Potter Material Serv., Inc.*), 781 F.2d. 99, 104 (7th Cir.1986); *Nimmer*, *supra* note 23 at 1044, we shall not address valuation methodology at this juncture. We believe the better course is to explore this issue at a later date, in the context of a concrete factual situation.

relief from the stay of the foreclosure sale of Bonner Mall should be granted.

VI. CONCLUSION

Viewed properly, "the new value exception" may be seen as a rule of construction, or a rule that serves to define the meaning of the absolute priority rule and determine when it has been satisfied. As such it is as pertinent today as it was under pre-Code bankruptcy practice. The arguments that Bancorp advances do not persuade us that Congress would have had any reason to disregard a beneficial rule of construction that assists courts in implementing an important bankruptcy doctrine at the very time it was incorporating that doctrine into the Bankruptcy Code.

Nothing in the text of the Code prohibits the confirmation of plans that properly employ the new value doctrine.

Nor does the legislative history demonstrate that Congress intended to abrogate this judicially created, pre-Code legal principle. Therefore, we conclude that the new value "exception", with its stringent requirements, survives. We recognize that, if applied carelessly, the doctrine has the potential to subvert the interests of creditors and allow debtors and old equity to abuse the reorganization process. The proper answer to these concerns is vigilance on the part of bankruptcy courts in ensuring that all of the requirements of the new value exception are met in every case. Here, it is unclear whether Bonner's plan can meet all of the requirements of the doctrine and achieve confirmation. Nevertheless, it may well be within the realm of potentially confirmable plans and thereby survive Bancorp's motion for

relief from the automatic stay. The bankruptcy court must make that determination initially.

The judgment of the district court is AFFIRMED and the case is REMANDED to the bankruptcy court for further proceedings consistent with this opinion.

Dale G. Higer
STOEL RIVES BOLEY JONES & GREY
One Capital Center, Suite 1015
999 Main Street
Boise, ID 83702-9000
Telephone: (208) 389-9000
Facsimile: (208) 389-9040

Bradford Anderson
STOEL RIVES BOLEY JONES & GREY
3600 One Union Square
600 University Street
Seattle, WA 98101-3197
Telephone: (206) 624-0900
Facsimile: (206) 386-7500

Attorneys for U.S. Bancorp Mtg. Co.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

In the Matter of	) Case No.
	) 92-0023-N-HLR
BONNER MALL PARTNERSHIP,)
)
Debtor.	) Consolidated
	) with Case No.
	) 20046-N-HLR
<hr/>	
BONNER MALL PARTNERSHIP,	) NOTICE OF
	) APPEAL
Appellant/Plaintiff,)
)
v.)
)
U.S. BANCORP MORTGAGE)
COMPANY,)
)
Appellee/Defendant.)
)

Notice is hereby given that U.S.
 Bancorp Mortgage Company,
 appellee/defendant above named, hereby
 appeals to the United States Court of
 Appeals for the Ninth Circuit, from the
 final Opinion and Order entered in this
 action on the 15th day of July, 1992, as
 corrected by the Correction Order dated
 July 23, 1992.

DATED this 14th day of August, 1992.

STOEL RIVES BOLEY JONES & GREY

By _____ /s/
 Dale G. Higer
 Bradford Anderson
 Of Attorneys for U.S. Bancorp
 Mortgage Company

1015
 One Capital Center, Suite
 999 Main Street
 Boise, ID 83702-9000
 (208) 389-9000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the
 14th day of August, 1992, a trust and
 correct copy of the foregoing NOTICE OF
 APPEAL was served upon the following by
 United States Mail, postage prepaid:

Jerome Shulkin
 Shulkin Hutton & Bucknell
 1201 Third Avenue, Suite 1900
 Seattle, WA 98101

Ford Elsaesser
 Elsaesser Jarazbek & Buchanan
 P.O. Box 1049
 Sandpoint, ID 83864

U.S. Trustee
 Office of the U.S. Trustee
 P.O. Box 110
 Boise, ID 83701

 /s/
 DALE G. HIGER

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

In re:)
)
BONNER MALL PARTNERSHIP,	) CASE NO.
	) NO. 92-
	) 0023-N-HLR
	) consolidated
	) with Case No.
Debtor.	) 92-0046-N-HLR
)
)
BONNER MALL PARTNERSHIP,)
)
Appellant/Plaintiff,)
)
v.)
)
U.S. BANCORP MORTGAGE)
COMPANY,	) CORRECTION
	) ORDER
Appellee/Defendant.)

It having come to the court's attention that a typographical error appears in its Opinion and Order filed July 15, 1992, wherein the Bankruptcy Court's Order of December 6, 1991, is listed as being dated December 6, 1992, IT IS HEREBY ORDERED that section "III. ORDER" at page 15 be corrected to read as follows:

Based upon the foregoing, and the court being fully advised in the premises,

IT IS HEREBY ORDERED that the Order of the bankruptcy court filed December 6, 1991, should be, and is hereby, REVERSED, and the case is REMANDED to the bankruptcy court for proceedings consistent with this opinion.

DATED this 23rd day of July,
1992.

/S/
HAROLD L. RYAN
UNITED STATES DISTRICT COURT

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

In re:)
)
BONNER MALL PARTNERSHIP,	) CASE NO.
92-	) 0023-N-HLR
)
consolidated	) with
	) Case No.
Debtor.	) 0046-N-HLR)
92-)
<hr/>	
BONNER MALL PARTNERSHIP,)
)
Appellant/Plaintiff,)
)
v.)
)
U.S. BANCORP MORTGAGE	) OPINION AND
COMPANY,	) ORDER
)
Appellee/Defendant.)
<hr/>	

I. FACTS AND PROCEDURE

This matter is currently before this court on appeal from an Order entered by the United States Bankruptcy Court for the District of Idaho on December 6,

1991. Having reviewed the entire record herein, the court determined that the decisional process would be significantly aided by oral argument. Accordingly, a hearing was held July 10, 1992.

The Debtor in this case is the Bonner Mall Partnership, an Idaho general partnership comprised of six partners. The Debtor was formed in 1986 for the purpose of acquiring the Bonner Mall (hereinafter "Mall"), a retail shopping center located on 16 acres of land one mile north of Sandpoint, Idaho, in Bonner County. Northtown Investments constructed the Mall in 1984-85 using a \$6.2 million loan from First National Bank of North Idaho. U.S. Bancorp Mortgage Company (hereinafter "U.S. Bancorp") acquired the loan from First National Bank of North Idaho in 1986. The Debtor purchased the Mall from Northtown Investments on October 31,

1986. The Debtor hoped to be able to service the debt with the rental income from the Mall tenants; however, this does not prove to be the case. In July 1990, a Notice of Default and a Notice of Trustee's Sale was filed against the Debtor on account of delinquent real property taxes. Subsequent negotiations between Bonner County, U.S. Bancorp and the Debtor to solve the tax problem and to restructure the debt, broke down. Thereafter, on March 13, 1991, the Debtor filed for relief under Chapter 11 of the United States Bankruptcy Code.

U.S. Bancorp filed a motion to dismiss the Chapter 11 proceeding, and also a motion to modify stay, seeking relief from the automatic stay under 11 U.S.C. § 362(a) to enable it to foreclose its security interest in the Bonner Mall. Both motions came on for hearing before the bankruptcy court. On August 23,

1991, the bankruptcy court issued its first Memorandum of Decision. That decision valued U.S. Bancorp's collateral, the Mall, at \$3.2 million and initially denied U.S. Bancorp's motions subject to the Debtor filing a plan of reorganization within 30 days. In this first decision, the bankruptcy court did not express any opinion as to the viability of the "new value exception" which is the basis of the present appeal.

On October 31, 1991, the Debtor filed its First Amended Plan of Reorganization. Under the plan, the Debtor is proposing to transfer all of the assets of the Mall to a new entity, Bonner Property, Inc. (hereinafter "Bonner Properties"). The existing partners of the Debtor would contribute to Bonner Properties \$200,000.00, plus amounts needed to complete court-ordered repairs. A non-debtor party would also

grant to Bonner Properties a collateral trust mortgage on 4500 acres of real property, the value of which seems to be disputed. In exchange for the capital contribution and the real property, the existing partners would receive two million shares of common stock in the corporation.

With respect to the Debtor's liabilities, the Plan provides for the secured portion of U.S. Bancorp's claim, equal to the \$3.2 million value of the Mall, to be repaid in a single "balloon" payment after 32 months, with U.S. Bancorp to receive monthly interest payments in the interim. The other secured creditors will also be paid the value of their collateral on a deferred basis. In regard to the unsecured creditors' class, of which U.S. Bancorp is also a member, the plan proposes a pro rata distribution of 300,000 shares of

Class A preferred stock in Bonner Properties. The shares would have a par value of \$1.00 and would be convertible at any time after the payment of U.S. Bancorp's secured claim into a maximum 15 percent of the then outstanding shares of common stock. The preferred stock is given a liquidation preference equal to its par value - \$300,000.00.

In response to the First Amended Plan of Reorganization, U.S. Bancorp renewed its motions for relief from stay and dismissal of the case, arguing that the Bankruptcy Code, enacted in 1978, did not retain the new value exception to the absolute priority rule, and therefore, the plan was not confirmable as a matter of law. After a hearing on the matter, the bankruptcy court issued a second Memorandum of Decision and a separate Order on December 6, 1991. The order granted U.S. Bancorp's motion for relief

from stay, and denied U.S. Bancorp's motion to dismiss. The Memorandum of Decision in support of the Order provides in relevant part:

Since the time of the previous decision on this subject in this case, the Fifth Circuit Court of Appeals in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture* has held the new value exception is not available under the Bankruptcy Code. The opinion holds the 1978 Bankruptcy Code did not provide for [the] new value exception to the absolute priority rule. The Court discussed the effect of allowing the exception under the present Code and found that to do so would allow "old equity" to retain control of, and run, the reorganized debtor while impairing the rights of dissenting secured creditors and that such treatment is not authorized and should not be authorized under the present statutes.

The Greystone analysis is convincing, as is the reasoning . . . in *In re Outlook/Century, Ltd.*, As in Greystone, to allow the debtor equity holders in this case to retain controlling interest in the new entity while reducing the amount of the [U.S.]

Bancorp secured claim and not paying the unsecured claim in full would violate the absolute priority rule.

Memorandum of Decision, filed Dec. 6, 1991, at 4-5 (footnotes omitted).

On December 11, 1991, Debtor filed its Notice of Appeal from the December 6, 1991, Memorandum of Decision and separate Order. On December 11, 1991, the bankruptcy court signed a formal order submitted by U.S. Bancorp. The Debtor filed a second notice of appeal on December 23, 1991, in response to the signing of the formal order. On February 11, 1992, this court issued an order consolidating the appeals.

Having thoroughly considered the briefs submitted herein, along with the entire record on appeal, and the arguments by counsel at the hearing held on July 10, 1992, the court finds that

the decision of the Bankruptcy Court should be reversed.

II. ANALYSIS

A. Issue on Appeal.

The sole issue before the court on appeal is whether the enactment of the 1978 Bankruptcy Code revoked the new value exception to the absolute priority rule recognized under the bankruptcy Act.

B. Standard of Review.

The bankruptcy court's findings of fact may not be disturbed on appeal unless clearly erroneous. Bankruptcy Rule 8013. However, the bankruptcy court's conclusions of law are reviewed *de novo*. *Ragsdale v. Haller*, 780 F.2d 794, 795 (9th Cir.1986).

C. History of the Absolute Priority Rule and the New Value Exception.

In order for a Chapter 11 plan of reorganization to be confirmed, it must

meet the requirements set forth in 11 U.S.C. § 1129. Section 1129(a) sets out these requirements, one of which is that each class of claims must accept the plan. However, there is an exception to this requirement in Section 1129(b). Section 1129(b)(1) provides that if all other requirements for confirmation under Section 1129(a) have been met, the court may confirm a reorganization plan over the objection of an impaired class or classes "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C.S. § 1129(b)(1) (1987) (emphasis added).

This fair and equitable standard was created by the courts around the turn of the century. The Supreme Court in *Louisville Trust Co. v. Louisville, N.*

Albany & Chicago Ry., 174 U.S. 674 (1899), fashioned what has become known as the absolute priority rule. The Supreme Court stated:

[T]he stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.

Id. at 684. In essence, "[t]he absolute priority rule requires that a dissenting class of creditors be provided for fully before any junior class may receive or retain any interest in the reorganized firm." *In re SLC LIMITED V.* 22 Bankr. Ct. Dec. (CRR) 1081, 1082 (Bankr. D. Utah 1992)).

The courts created an exception to this rule, known as the "new value exception." *In Kansas City Terminal Ry.*

Co. v. Central Union Trust Co., 271 U.S. 445 (1926), the Supreme Court explained:

As above stated, to the extent of their debts creditors are entitled to priority over stockholders against all the property of an insolvent corporation. But it does not follow that in every reorganization the securities offered to general creditors must be superior in rank or grade to any which stockholders may obtain. It is not impossible to accord to the creditor his superior rights in other ways. Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.

Id. at 455.

The fair and equitable language was incorporated into the former Bankruptcy Act in Section 77B. The Supreme Court in *Case v. Los Angeles Lumber Products Co.*,

308 U.S. 106 (1939), was called upon to decide whether the absolute priority rule and the new value exception had been codified in the Act. The Supreme Court concluded that both had been codified.

It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Ry. Co. v. Boyd*, *supra*, and *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, *supra*. Especially in the latter case did this Court stress the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

Id. at 121 (citations omitted) (footnote omitted).

Presently, courts have placed strict conditions on the application of the new value exception.

In order for the new value exception to apply, the contribution made by the equity holder must be: 1) in "money or money's worth"; 2) "reasonably equivalent" in value to the continued participation of the stockholders; 3) "necessary" to the reorganization; 4) a "fresh" contribution to the reorganization.

In re Sovereign Group, No. 89-10721F, 1992 U.S. Dist. LEXIS 9177 at *16 (E.D. Pa. June 30, 1992) (citation omitted).

Section 77B was replaced by Section 1129(b) of the Bankruptcy Code enacted in 1978. As stated above, the fair and equitable language has been adopted in this section. The section further provides in part:

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

.....
 (B) With respect to a class of unsecured claims -

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C.S. § 1129(b)(2) (1987).

D. In Regard to the Existence of the New Value Exception.

Appellant argues that the new value exception survived the enactment of the 1978 Bankruptcy Code and is still applicable under Section 1129(b). In the bankruptcy court's second Memorandum of Decision, cited above, the Court found the Fifth Circuit's decision in Greystone "convincing." Subsequent to the

bankruptcy court's decision, the Fifth Circuit, upon rehearing of the earlier Greystone decision, withdrew the portion of the earlier decision addressing the new value exception to the absolute priority rule. The Fifth Circuit stated: "[T]he bankruptcy court's opinion on the 'new value exception' to the absolute priority rule has been vacated and we express no view whatever on that part of the bankruptcy court's decision."

Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture, 948 F.2d 134, 142 (5th Cir.1991) (as amended on Petition for Rehearing, per curiam, Feb. 27, 1992).

Appellant contends that the withdrawal of the earlier Greystone opinion undermines the bankruptcy court's decision, since the bankruptcy court relied so heavily on that opinion. In addition, appellant also cites other circuit and district courts which have stated their belief

that the new value exception survived the enactment of the 1978 Bankruptcy Code.

Appellant asserts that under the application rules of statutory construction, the new value exception was not eliminated. Specifically, appellant cites *Dewsnup v. Timm*, 502 U.S. ___, 116 L. Ed. 2d 903 (1992). Appellant argues that this case requires the court to construe Section 1129(b) consistent with pre-Code practices, including recognizing the existence of the new value exception.

In addition, appellant argues that the language of the statute is not inconsistent with the new value exception. Specifically, the appellant argues that the use of the word "includes" in Section 1129(b)(2) shows that the statute does not purport to be all inclusive. Section 102(3) states, "'includes' and 'including' are not limiting. . . ." 11 U.S.C. § 102(3)

(1985). Therefore, the appellant argues that the statute is not inconsistent with the new value exception.

In response, appellee argues that the Fifth Circuit's withdrawal of its earlier opinion does not undermine the bankruptcy court's decision in the instant case. The appellee points out that the bankruptcy court's decision also adopted the reasoning in *In re Outlook/Century Ltd.*, 127 B.R. 650 (Bankr. N.D. Cal. 1991), which held that the new value exception does not exist. In addition, appellee also cites cases from circuit and district courts that support its position that the new value exception no longer exists under the Code.

Appellee further argues that neither the statute nor the legislative history mention a new value exception. Appellee contends that Congress must have known of

the new value exception, and, therefore, its silence illustrates its intent to abolish that exception as it relates to Section 1129(b).

Appellee asserts that the language of the statute is unambiguous. Appellee also maintains that the former Bankruptcy Act stated the fair and equitable standard, but failed to furnish a definition. In contrast, appellee argues, the new Section 1129 defines "fair and equitable" by setting out the minimum requirements for a plan to be "fair and equitable." Appellee argues that *Dewsnup* is really inapplicable. In *Dewsnup*, the Supreme Court stated, "[o]f course, where the language is unambiguous, silence in the legislative history cannot be controlling." *Dewsnup v. Timm*, 116 L. Ed. 2d at 913.

Therefore, appellee argues that the language of Section 1129 is unambiguous,

and urges the court to adopt the plain meaning of the statute and not construe the statute as consistent with pre-Code practices.

The court notes that the Ninth Circuit has yet to decide whether the new value exception has survived enactment of the Bankruptcy Code. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), the Supreme Court refused to resolve the issue of whether the new value exception survived.

We need not reach this question to resolve the instant dispute. As we discuss *infra* . . . we think it clear that even if the Los Angeles Lumber exception to the absolute priority rule has survived enactment of the Bankruptcy Code, this exception does not encompass respondents' promise to contribute their "labor, experience, and expertise" to the reorganized enterprise.

Thus, our decision today should not be taken as any comment on the continuing vitality of the Los Angeles

Lumber exception - a question which has divided the lower courts since passage of the Code in 1978.

Id. at 203 n.3 (citations omitted).

This issue is essentially one of statutory construction. Since the bankruptcy court's decision, a new opinion has been issued which prescribes new standards for interpreting the Bankruptcy Code. In *Dewsnup*, the Supreme Court stated:

When Congress amends the bankruptcy laws, it does not write "on a clean slate." . . . Furthermore, this Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history. . . . Of course, where the language is unambiguous, silence in the legislative history cannot be controlling.

Dewsnup v. Timm, 116 L. Ed. 2d at 912-13 (citations omitted). The *Dewsnup* opinion

gives courts new guidelines when attempting to interpret the language of the Bankruptcy Code. The Supreme Court makes it clear that when the language of the code is somewhat ambiguous, courts should try to construe the language as consistent with pre-Code practices, unless some contrary intent is shown in the legislative history. The language at issue here is ambiguous to a certain extent. No mention is made in the language or the legislative history of the new value exception; yet, various courts have interpreted this language differently and are split on this issue, which illustrates that this language is not as clear as appellee argues. Furthermore, the use of the word "includes" demonstrates that the new value exception is not inconsistent with the language of Section 1129(b), since the requirements put forth are not all

inclusive. In addition, there is no evidence in the language of the statute or the legislative history which would indicate the desire of Congress to abandon the new value exception.

Two cases have addressed this issue since the *Dewsnup* opinion was handed down, and both have found that the new value exception survives. In *In re Sovereign Group, supra*, the court stated:

On the other hand, the statutory language appears to be less clear in light of the fact that the new value exception is a judicially created exception which was in full use prior to the enactment of the Code in 1978. Where Congress intends for legislation to change the interpretation of judicially created concepts, it makes that intent specific; absent such specific intent, it is presumed that congress did not intend to change prior-existing law. *Midlantic National Bank v. New Jersey Department of Environmental Protection*, 474 U.S. 494, 501 (1986).

Additionally, the Supreme Court recently reasserted the

significance of bankruptcy practice prior to the passage of the Code and the Court's unwillingness to interpret the Code in a manner contrary to pre-Code practice. . . . *Dewsnup v. Timm*, 112 S.Ct. 773, 779 (1993) (citations omitted). This court is likewise hesitant to read the Code in contravention of pre-Code practice and will not hold that the new value exception has been extinguished.

Id. at *13-14.

In *In re SLC LIMITED V, supra*, the bankruptcy court also held that the new value exception survived the enactment of the 1978 Bankruptcy Code.

Section 1129(b)(29) references some of the requirements of the "fair and equitable" standard, but on its face, it does not statutorily exclude nor eliminate the new value exception to the absolute priority rule. The use of the term "includes" also indicates that the requirements set forth in section 1129(b)(2)(B) are not limited to those indicated in that section.

Id. at 1083.

The court reiterated the *Dewsnup* analysis, and stated:

Likewise, congressional silence regarding codification of the new value exception cannot be interpreted as eliminating a substantial, judicially created exception to the absolute priority rule especially when § 1129(b)(2) is not ambiguous on its face.

. . . .

Absent a showing of specific intent to change the judicially created new value exception, especially considering the plain language of the statute, it is not necessary in this case to "venture into the thicket of legislative history" to determine the scope of § 1129(b)(2). . . .

. . . .

Furthermore, the notion that the definition of "fair and equitable" is not longer a matter of common law and that section 1129(b)(2) "defines" it expressly is not supported by the legislative history.

Id. at 1084-85 (citations omitted).

The Fifth Circuit's withdrawal of the portion of the earlier *Greystone*

decision addressing the new contribution exception to the absolute priority rule further illustrates the trend after *Dewsnup* to interpret Section 1129(b) as consistent with pre-Code practices.

Although the Fifth Circuit's decision to withdraw the earlier portion does not state whether it was influenced by the Supreme Court's decision in *Dewsnup*, the dissenting judge on rehearing seemed to imply that it did. "How one should approach issues of a statutory construction arising from the Bankruptcy Code has been clouded, in my view, by *Dewsnup v. Timm*. . . ." *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture*, 948 F.2d at 142 (Jones, J., dissenting).

In addition, the language of the Code must be read in light of the underlying bankruptcy principles.

"[C]ontinued application of the new value

exception comports with the policy underlying Chapter 11 reorganizations.

The purpose of Chapter 11 is to successfully rehabilitate the Debtor.

N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984)."
In re Sovereign Group, No. 89-10721F, 1992 U.S. Dist. LEXIS at *15 n.9.

In conclusion, the court finds that the new value exception to the absolute priority did survive the enactment of the 1978 Bankruptcy Code. This interpretation of the bankruptcy Code is consistent with the guidelines enunciated in *Dewsnup*, as well as the underlying policy of Chapter 11.

Lastly, in clarifying the issues on appeal, the court finds that the single issue before the court is whether the judicially created new value exception to the absolute priority rule survived the enactment of the 1978 Bankruptcy Code.

Although the appellee has briefed the issue of confirmation, the court will not address this issue on appeal.

Confirmation of the plan proposed by the Debtor must be addressed by the bankruptcy court on remand.

III. ORDER

Based upon the foregoing, and the court being fully advised in the premises,

IT IS HEREBY ORDERED that the Order of the bankruptcy court filed December 6, 1992, should be, and is hereby, REVERSED, and the case is REMANDED to the bankruptcy court for proceedings consistent with this opinion.

DATED this 15th day of July, 1992.

/S/

HAROLD L. RYAN

UNITED STATES DISTRICT COURT
 IN THE UNITED STATES BANKRUPTCY COURT
 FOR THE DISTRICT OF IDAHO

In re:)
)
 BONNER MALL PARTNERSHIP,) Case No. 91-
) 00801-11
)
 Debtor.) MEMORANDUM OF
) DECISION
)
)

Ford Elsaesser and Barbara Buchanan,
 ELSAESER, JARZABEK, BUCHANAN & DRESSEL,
 Sandpoint, Idaho, and Jerome Shulkin,
 SHULKIN, HUTTON & BUCKNELL, Seattle,
 Washington, for debtor.

Dale G. Higer and Thomas R. Linville,
 EBERLE, BERLIN, KADING, TURNBOW &
 McKLVEEN, Boise, Idaho, for U.S. Bancorp
 Mortgage Company.

U.S. Bancorp has moved for relief
 from the Section 362 automatic stay and
 to dismiss the debtor's Chapter 11
 petition.

After a hearing, it appears the
 granting of either motion depends on the
 ability of the debtor to formulate and
 obtain confirmation of a plan of

reorganization under the statutory
 provisions of Chapter 11 of Title 11 of
 the United States Code. If it is
 apparent the debtor cannot obtain
 confirmation of a Chapter 11 plan in
 accordance with its purposes of
 reorganization, stay relief is
 appropriate under the *Timbers* decision of
 the United States Supreme Court¹ and
 dismissal would be appropriate under the
 provisions of 11 U.S.C. § 1112(1) or (2).

Considering the motion for stay
 relief, as it is possible for the Bank to
 be adequately protected pending the
 filing of a Chapter 11 plan through
 adequate protection payments and the Bank
 is presently collecting the rents, since
 the property involved is the property
 sought to be reorganized, and since no

¹ *United States Assn. v. Timbers of Inwood Forest*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740 (1988).

other ground for cause for stay relief has been shown by the Bank to exist under the provisions of Section 362(d)(1), the issues are dependent on the prospective ability of the debtor to formulate a plan.

The dilemma the debtor faces is the requirement, recognized by the *Timbers* decision, a Chapter 11 debtor must have a realistic prospect of an effective reorganization.

Section 362(d)(2) also belies petitioner's contention that undersecured creditors will face inordinate and extortionate delay if they are denied compensation for interest lost during the stay as part of "adequate protection" under § 362(d)(1). Once the movant under § 362(d)(2) establishes that he is an undersecured creditor, it is the burden of the debtor to establish that the collateral at issue is "necessary to an effective reorganization". See § 362(g). What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it;

but that the property is essential for an effective reorganization that is in prospect. This means, as many lower courts, including the en banc court in this case, have properly said, that there must be "a reasonable possibility of a successful reorganization within a reasonable time." 808 F.2d, at 370-371, and nn. 12-13, and cases cited therein. The cases are numerous in which § 362(d)(2) relief has been provided within less than a year from the filing of the bankruptcy petition. And while the bankruptcy courts demand less detailed showings during the four months in which the debtor is given the exclusive right to put together a plan, see 11 U.S.C. §§ 1121(b), (c)(2), even within that period lack of any realistic prospect of effective reorganization will require § 362(d)(2) relief. (Footnotes omitted.)²

Under provisions of 11 U.S.C. § 1129(b), since the Bank is an undersecured creditor, the Bank would most likely be in a position to block acceptance of any proposed plan of

² *United Savings Assn. v. Timbers of Inwood Forest*, 484 U.S. at 375, 376.

reorganization which contains an impairment of its secured claim.³ The Bank is definitely undersecured. The property sought to be reorganized, the Bonner Mall, is valued by the Bank at \$3.8 million and by the debtor at \$2.4 million. The Bank's claim is \$6.3 million. The debtor's scheme of reorganization depends upon the reduction of the Bank's claim to the value of the security. It is thus difficult to envision how the debtor will be able to obtain confirmation of a plan under the Chapter 11 statutory requirements, nevertheless, the debtor's contentions will be considered.

Counsel for the debtor contends other unsecured creditors exist who would affect the plan acceptance provisions of

11 U.S.C. § 1126(c), including the claims of the individual partners who comprise the debtor limited partnership. However, the debtor's schedules indicate the only other unsecured claims are \$62,178.00 owing to the Magnuson Children Trusts and a priority tax claim of Bonner County of \$195,500.00.

Counsel for the debtor further contends it may be possible to obtain confirmation of a plan by providing for separate classes of unsecured debt. Yet, under the provisions of 11 U.S.C. § 1129(a)(8), each class of impaired claims or interests must accept the plan. Otherwise, the provisions of Section 1129(b) apply and the debtor would be required to pay the unsecured claim of the Bank in full under the absolute priority rule provisions of Section 1129(b).

³ *In re South Village Inc.*, 25 B.R. 987 (Bankr. D. Utah 1982) and *Matter of DRW Property Co.* 82, 57 B.R. 987 (Bankr.N.D. Tex. 1986).

Lastly, counsel for the debtor argues there exists a possibility of a successful reorganization since Harry Magnuson intends to contribute additional capital. An exception to the absolute priority rule exists in the form of "infusion of new capital," commonly called the *Los Angeles Lumber* exception.⁴ Simply stated, the debtor can retain an interest in the Chapter 11 estate ahead of creditors to the extent new capital is put into the estate by the debtor.

However, the *Los Angeles Lumber* case, and cases decided since, have developed requirements for the exception. One of the requirements, and the most demanding, is the requirement the debtor contribute

⁴ *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986); Polen and Wuhrman, the new value exception to the absolute priority rule, 93 Comm. L.J. 303; *In re Henke*, 90 B.R. 451 (Bankr. Mt. 1988); *Matter of Yasparro*, 100 B.R. 91 (Bankr. M.D. Fla. 1989).

capital "reasonably equivalent" to the interest retained.⁵ The value is the fair market value of the property retained, valued at the time of confirmation.⁶

While it is doubtful neither the debtor, nor the members of the debtor partnership, intend to contribute capital to the extent required under the infusion of new capital doctrine, discussion of the subject requires a determination of the value of the Mall.

In arriving at a proper value for the Bonner Mall, problems are posed by both appraisals. The debtor's appraisal of \$2.4 million was based only on an income approach. The income approach does not take into consideration the

⁵ *Case v. Los Angeles Lumber Products Co.*, 308 U.S. at 122, 60 S. Ct. at 10, 84 L. Ed. at 123. *In re Potter Material Service, Inc.*, 781 F.2d at 103. *Matter of Yasparro*, 100 B.R. at 97, 98.

⁶ *Matter of Yasparro*, 100 B.R. at 99.

occupancy potential of the Mall but considers only the poor occupancy status which presently exists. Yet the Bank's appraisal moves too far in the opposite direction, taking into consideration market value comparisons with successful malls in different localities which make comparable adjustments extremely difficult. The Bank's appraisal is further suspect in the computation of the income approach considering the basic data used and the capitalization rate used.

While the debtor is appealing the \$3.2 million assessed valuation figure of the Bonner County Tax Assessor, this figure appears to be more realistic than either the debtor's or the Bank's respective valuation. Accordingly, the value of the Bonner Mall is thus found to be \$3.2 million, based on the evidence presented at this hearing.

The debtor will be allowed thirty (30) days to file a Chapter 11 reorganization plan and disclosure statement which is not subject to rejection as a matter of law. If no plan is filed within the thirty day period, both the Bank's motions will be granted without further hearing, under the provisions of Sections 1112(b)(1) and (2) and 362(d)(2) respectively, upon presentation of an appropriate order or orders by counsel for the Bank. If a plan is filed, its potential for confirmation may be considered by notice and hearing, with reduced time requirements if necessary, on motion of the Bank, otherwise the Bank's motions will be denied.

It is further found the debtor has not been guilty of unreasonable delay under the provisions of Section 1112(b)(3) and no bad faith exists on the

part of the debtor or the individual partners of the debtor.

The debtor's motion for use of cash collateral to require the Bank to apply \$5,000.00 per month of the Yokes rentals on the \$905,000.00 loan will be denied.

The funds are sought to be used not by the debtor-in-possession, but are intended to be used in payment of a debt other than a debt of the debtor. While unquestionably the debtor benefitted from the series of transactions which brought the "Yoke's" store into the Mall, the funds are presently being used more appropriately as part of the Bank's adequate protection.

The contents of this decision shall constitute formal findings of fact, conclusions of law and applicable orders.

IT IS SO ORDERED.

Dated this 23rd day of August

1991.

/S/

ALFRED C. HAGAN
U.S. BANKRUPTCY JUDGE

2
NOV 30 1993

No. 93-714

OFFICE OF THE CLERK

In The
Supreme Court of the United States
October Term, 1993

U.S. Bancorp Mortgage Company,

Petitioner,

v.

Bonner Mall Partnership,

Respondent.

Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF IN OPPOSITION

BARBARA BUCHANAN
JOHN FORD ELSAESSEN, JR.
Counsel of Record

ELSAESSER JARZABEK &
BUCHANAN, CHTD.
Third & Lake Streets
P.O. Box 1049
Sandpoint, ID 83864
(208) 263-8517
Counsel for Respondent

RULE 29.1 LIST

NONE.

TABLE OF CONTENTS

	Page
STATEMENT OF THE CASE.....	1
I. Nature of the Case	1
II. Statement of Facts.....	2
III. Course of Proceedings.....	6
SUMMARY OF THE ARGUMENT	9
ARGUMENT	11
I. The issue of the survival of the New Value Exception is not ripe for decision by this Court	11
II. The decision below is in accord with applicable decisions of this Court.....	14
III. The decision below is not in direct conflict with any other circuit level authority.....	17
CONCLUSION	20

APPENDIX

1. Memorandum of Decision, United States Bankruptcy Court for the District of Idaho..... A1

TABLE OF AUTHORITIES

	Page
CASES	
<i>In re Anderson</i> , 913 F.2d 530 (8th Cir. 1990).....	17
<i>Case v. Los Angeles Lumber Co.</i> , 308 U.S. 106 (1939).....	7, 14, 15, 16
<i>Dewsnup v. Timm</i> , 502 U.S. ____ 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992).....	9, 10, 14, 17, 19
<i>Kansas City Terminal Ry v. Central Union Trust Co.</i> , 271 U.S. 445 (1926).....	15
<i>Midlantic National Bank v. New Jersey Dept. of Environmental Protection</i> , 474 U.S. 494 (1986).....	16
<i>NLRB v. Bildisco & Bildisco</i> , 465 U.S. 513 (1984)....	12, 13
<i>Northern Pacific Railway Co. v. Boyd</i> , 228 U.S. 482 (1913).....	15
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988).....	14
<i>Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture</i> , 948 F.2d 203 (5th Cir. 1991)	8, 10, 15, 19
<i>Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture</i> , 995 F.2d 1274 (5th Cir. 1992)	10, 15, 19, 20
<i>In re Pullman Constr. Indus., Inc.</i> , 107 Bankr. 909 (N.D. Ill. 1989)	12
<i>In re SLC Ltd V</i> , 22 Bankr. Ct. Dec. 1081 (D. Utah 1992).....	16
<i>Snyder v. Farm Credit Bank of St. Louis</i> , 967 F.2d 1126 (7th Cir. 1992).....	18
<i>Snyder v. Farm Credit Bank of St. Louis</i> , 99 Bankr. 885 (C.D. Ill. 1989)	18, 19, 20

TABLE OF AUTHORITIES - Continued

Page

<i>In re Tallahassee Associates, L.P.</i> , 132 Bankr. 712 (W.D. Penn. 1991)	12, 20
<i>In re U.S. Truck Co.</i> , 800 F.2d 581 (6th Cir. 1986)	18

STATUTES AND OTHER AUTHORITIES

11 U.S.C. § 1129.....	13, 14, 19
11 U.S.C. § 506(d)	17
Rule 10, Rules of the Supreme Court (Jan. 1, 1990)	10, 20

U.S. Bancorp Mortgage Company,

Petitioner,

v.

Bonner Mall Partnership,

Respondent.

**Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit**

BRIEF IN OPPOSITION

STATEMENT OF THE CASE

I. NATURE OF THE CASE

This case arises out of a Chapter 11 bankruptcy proceeding which is currently pending before the United States Bankruptcy Court for the District of Idaho. U.S. Bancorp, the major secured creditor, is seeking to have the Chapter 11 proceeding dismissed, or in the alternative, to be granted relief from stay, on the grounds that the debtor's proposed Plan of Reorganization violates the absolute priority rule and is unconfirmable as a matter of law.

The sole issue on appeal is whether the enactment of the 1978 Bankruptcy Code revoked the new value exception to the absolute priority rule recognized under the Bankruptcy Act. The bankruptcy court held that the new value exception did not survive enactment of the Code and granted U.S. Bancorp's motion for relief from stay. The Federal District Court reversed and the Ninth Circuit affirmed the district court.

II. STATEMENT OF FACTS

The Petitioner's factual and procedural history is sparse and incomplete. Respondent is providing the following statement in an attempt to present the case in a full and complete perspective. The Respondent in this case is the Bonner Mall Partnership, an Idaho general partnership comprised of six partners. Lloyd Andrews, an individual, owns a 25% interest in the partnership. Five individual trusts comprise the remaining partners, with each trust holding a 15% interest. H.F. Magnuson is the trustee for each of the five trusts.

The Partnership was formed in 1986 for the specific purpose of acquiring the Bonner Mall, a retail shopping center located on 16 acres of land one mile north of Sandpoint, Idaho in the small community of Ponderay.

The Bonner Mall was constructed in 1984 and 1985 by Northtown Investments, an Idaho general partnership comprised of seven individuals and their spouses. Lloyd Andrews was one of the seven Northtown partners. Neither the trusts nor H.F. Magnuson, the trustee, held any interest in Northtown Investments. On February 17, 1985,

First National Bank of North Idaho (FNB) loaned Northtown Investments \$6.2 million secured by a note and deed of trust on the Bonner Mall. In 1986, FNB sold the loan to Petitioner U.S. Bancorp Mortgage Company (U.S. Bancorp).

The Partnership purchased the mall, including the mall buildings and the surrounding real estate from Northtown Investments on October 31, 1986. The Partnership did not, however, assume the U.S. Bancorp debt and neither the Partnership nor H.F. Magnuson is personally liable for the \$6.2 million debt. The Partnership has continuously owned and operated the Bonner Mall since October 31, 1986.

The Partnership made the purchase with the full expectation that the rental income from the mall's tenants would be sufficient to service the debt. Unfortunately, that did not prove to be the case. The Partnership was never able to establish and maintain a stable tenant base sufficient to cover the operating expenses and service the indebtedness.

On July 10, 1990, U.S. Bancorp caused a notice of default and a notice of trustee's sale to be filed against the Bonner Mall Partnership noticing the property up for a trustee's sale on November 20, 1990. That same day, U.S. Bancorp sent letters to all of the tenants in the Bonner Mall demanding that all rents be paid directly to U.S. Bancorp. Since that date, U.S. Bancorp has been receiving the rental income from the mall.

The sole basis for the notice of default and the notice of trustee's sale was the fact that the Partnership was delinquent on its real property taxes to Bonner County.

The notice of default cited the Partnership's failure to "pay at least ten days before delinquency all taxes and assessments" effecting the Bonner Mall property. The Partnership was current on all its obligations to U.S. Bancorp in July of 1990, when the Notice of Default was filed.

Between July 1990 and March of 1991, the Partnership was involved in extensive negotiations with both Bonner County and U.S. Bancorp in an effort to solve the tax assessment problem and, even more significantly, to restructure the \$6.2 million indebtedness. It had become evident to all parties that the Bonner Mall could not service the \$6.2 million indebtedness and would not be able to do so in the foreseeable future. The negotiations between U.S. Bancorp and the Partnership centered upon agreeing to a realistic value for the Bonner Mall and the possibility of writing the \$6.2 million debt down to an amount which would more accurately reflect that value. The parties were unable to reach a resolution, and after three postponements, the trustee's sale was rescheduled for March 14, 1991. In order to prevent a non-judicial foreclosure sale on the Bonner Mall, the Partnership filed for relief under Chapter 11 of the United States Bankruptcy Code on March 13, 1991.

The Bonner Mall is currently being managed by R. W. Robideaux & Company, a Spokane based property management firm. U.S. Bancorp continues to receive all of the rental income from the mall and continues to pay the monthly operating expenses pursuant to a stipulation for adequate protection.

The Debtor is proposing through its First Amended Plan of Reorganization to transfer all of the assets of the estate from the existing partnership to a new corporation, Bonner Properties, Inc., the reorganized debtor. In exchange for their claims, the unsecured creditors would receive 300,000 shares of Class A preferred stock in the new corporation. The shares would have a par value of \$1.00 and would be convertible at any time after the payment of U.S. Bancorp's secured claim into 15% of the then outstanding shares of common stock. In the event of a liquidation, the preferred stock is given a liquidation preference, ahead of the common stock, equal to its par value - \$300,000.

In order to fund the reorganization, the Plan proposes for the existing trusts and Lloyd Andrews, to make a capital contribution of \$200,000 plus additional amounts needed to complete the court authorized repairs to the mall and to cover any shortfall in operating expenses for a 32 month period following confirmation of the Plan. Additionally, the trustee for the five trusts, H. F. Magnuson, proposes to grant to the reorganized debtor a collateral trust mortgage on 4500 acres of real property with a fair market value of approximately \$4.5 million and an equity value of approximately \$2 million. In exchange for a capital contribution of \$300,000 plus in cash and approximately two million dollars in real property, the existing partners would receive 2 million shares of common stock in the corporation.

The Plan proposes to pay U.S. Bancorp's \$3.2 million secured claim in full 32 months after the effective date of the Plan. In the interim, U.S. Bancorp would receive monthly interest payments at a rate to be set by the court.

The Plan proposes to pay the other secured creditors the allowed value of their secured claim over various time periods with interest.

III. COURSE OF PROCEEDINGS

Bonner Mall Partnership filed its petition for relief under Chapter 11 of the United States Bankruptcy Code on March 13, 1991. Fourteen days later, before Debtor's bankruptcy schedules and statement of affairs had been completed and filed, U.S. Bancorp filed a motion to dismiss the Chapter 11. The Debtor filed its memorandum in opposition to the motion to dismiss on April 16, 1991. On April 23, 1991, before the motion to dismiss could be heard, U.S. Bancorp filed a Motion to Modify Stay seeking relief from the automatic stay under 11 U.S.C. § 362(a) to foreclose its security interest in the Bonner Mall. Both motions came on for hearing before the Honorable Alfred C. Hagan, U.S. Bankruptcy Judge for the District of Idaho on June 13, 1991, and again on July 2, 1991.

On August 23, 1991, Judge Hagan issued his first Memorandum of Decision. That decision valued U.S. Bancorp's collateral, the Bonner Mall, at \$3.2 million and provisionally denied both the motion for relief from stay and the motion to dismiss. The court gave the Debtor thirty (30) days to file a Chapter 11 plan and disclosure statement which were not subject to rejection as a matter of law. With regard to the possibility of confirming a plan of reorganization given the strictures of the absolute priority rule, the court stated as follows:

An exception to the absolute priority rule exists in the form of "infusion of new capital", commonly called the *Los Angeles Lumber* exception. Simply stated, the debtor can retain an interest in the chapter 11 estate ahead of creditors to the extent new capital is put into the estate by the debtor.

(Judge Hagan's initial decision is appended to the Petition for Writ of Certiorari at A118-A129. The above referenced quote is found at A124.)

Debtor filed its Plan of Reorganization and Disclosure Statement on September 23, 1991. On October 4, 1991, U.S. Bancorp renewed its motions for relief from stay and dismissal asserting that the Plan and disclosure statement were unconfirmable as a matter of law.

On October 31, 1991, Debtor filed its First Amended Plan of Reorganization and First Amended Disclosure Statement. The hearing on the renewed motions and on the first amended disclosure statement took place on November 13, 1991. Both counsel for the Debtor and counsel for U.S. Bancorp submitted written memorandum in support of their positions on the renewed motions. Pursuant to a stipulation by the parties that the issue for determination was purely a legal issue, the court heard no testimony and took no evidence at the November 13, 1991, hearing. Counsel for both sides presented oral argument and the court took the motions under advisement.

On December 6, 1991, the bankruptcy court issued its second memorandum of decision. The decision granted U.S. Bancorp's motion for relief from stay to foreclose its security interest in the Bonner Mall. In so doing, the court reversed its earlier ruling that a debtor may retain an

interest in a Chapter 11 estate ahead of creditors to the extent the debtor contributes new value, citing the Fifth Circuit Court of Appeals' decision in *Phoenix Mutual Life Ins. Co. v. Greystone III Venture*, 948 F.2d 134 (5th Cir. 1991), withdrawn in relevant part (per curiam) (Jones, J. dissenting from withdrawal), cert. denied, ___ U.S. ___, 113 S. Ct. 72, 121 L. Ed. 2d 37 (1992).

Since the time of the previous decision on this subject in this case, the Fifth Circuit Court of Appeals in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture* has held the new value exception is not available under the Bankruptcy Code. The opinion holds the 1978 Bankruptcy Code did not provide for new value exception to the absolute priority rule. The Court discussed the effect of allowing the exception under the present Code and found that to do so would allow "old equity" to retain control of, and run, the reorganized debtor while impairing the rights of dissenting secured creditors and that such treatment is not authorized and should not be authorized under the present statutes.

The Bankruptcy Court's second opinion is reported at 91 IBCR 187 (Idaho 1991) and reprinted at Appendix A1-A3.

On December 11, 1991, Debtor filed its Notice of Appeal from the December 6, 1991, Memorandum of Decision and Order. On December 9, 1991, Debtor filed a Motion for Stay Pending Appeal. The motion was heard before the bankruptcy court on January 6, 1992. On January 14, 1992, Judge Hagan entered an order granting stay pending appeal.

The matter was argued before the district court, the Honorable Harold L. Ryan presiding, on July 10, 1992. On

July 15, 1992, Judge Ryan issued his Opinion and Order. The district court found that the single issue before it on appeal was "whether the judicially created new value exception to the absolute priority rule survived the enactment of the 1978 Bankruptcy Code." (The District Court's Opinion and Order is reprinted at A88-A117 of the Petition for Writ of Certiorari. The above referenced quote is found at A98.) The court, focusing on the guidelines for statutory construction recently enunciated by this court in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992) and on the underlying policy of Chapter 11 of the Bankruptcy Code, reversed the bankruptcy court and held that it did. See Petition at A88-A117.

U.S. Bancorp timely appealed to the Ninth Circuit. Oral argument to the Circuit Panel took place on March 2, 1993. On August 4, 1993, the Ninth Circuit issued its decision affirming the judgment of the district court and remanding the case to the bankruptcy court for further proceedings. (The Ninth Circuit's opinion is appended to the Petition for Writ of Certiorari at A1-A84.) U.S. Bancorp is before this Court seeking a writ of certiorari to review the Ninth Circuit decision.

SUMMARY OF THE ARGUMENT

This Court should only grant a petition for writ of certiorari when a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; has decided a federal question in a way that conflicts with

applicable decisions of this Court; or when the case involves an important question of federal law which has not been, but should be, settled by this Court. Rule 10, Rules of the Supreme Court (Jan. 1, 1990).

Despite U.S. Bancorp's assertion to the contrary, the Ninth Circuit's decision in *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.*, is not in conflict with any other decision of a United States court of appeal; nor is it in conflict with applicable decisions of this Court. The only circuit court decision directly in conflict with the Bonner Mall opinion was the Fifth Circuit's original decision in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture (In Re: Greystone III Joint Venture)*, 948 F.2d 134, Part IV (5th Cir. 1991). The Fifth Circuit withdrew the portion of its decision rejecting the new value exception four months later, in response to this Court's decision in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992). See 995 F.2d 1274, 1284-85.

The *Bonner Mall* decision is fully consistent with recent decisions of this Court. In *Dewsnup*, 502 U.S. at ___, 112 S. Ct. at 779, this Court held that where the text of the Bankruptcy Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended pre-Code practice to continue unless the legislative history dictates a contrary result. As the Ninth Circuit Panel recognized, the legislative history of the Bankruptcy Code supports the continued existence of the new value doctrine. See Petition, at A57-A58. The judgment of the Ninth Circuit in the instant case is in accord with this Court's decisions interpreting the Bankruptcy Code.

Respondent concedes that the new value exception involves an important issue of federal law, however, Respondent does not concede that the issue is ripe for review by this Court. While federal district courts and bankruptcy courts nationwide have divided on the issue, the majority of courts that have considered the question have held that the new value exception survived enactment of the Bankruptcy Code. See Petition, at A31-A32.

The Ninth Circuit's decision is in accord with the majority position; is not in conflict with any other circuit level authority; and follows the most recent decisions of this Court interpreting the Bankruptcy Code. The decision should not be reviewed.

ARGUMENT

I. The issue of the survival of the new value exception is not ripe for review by this Court.

The existence of the new value doctrine is an important question of federal law which has been largely settled by the Ninth Circuit's decision in the *Bonner Mall* case. U.S. Bancorp suggests in its petition that this Court should accept certiorari on public policy considerations:

The new value exception would profoundly diminish creditors' control over the reorganization process.

. . .

This issue occurs frequently in bankruptcy cases and is of considerable importance to the lending community. The issue raises significant public

policy considerations in that the existence of the new value exception adds tremendous uncertainty to credit markets. The new value exception in essence allows the bankruptcy court to write new loans for lenders on terms they never envisioned and which, in their business judgment, they would not consider prudent. See Petition for Writ of Certiorari, at 8-9.

Respondent asserts that there are important public policy considerations which weigh in favor of recognizing the continuing viability of the new value exception. The new value exception was created by courts in response to the recognition that inflexible application of the absolute priority rule would, in many instances, subvert the very process of reorganization which the rule was intended to promote. *In re Tallahassee Associates*, 132 Bankr. 712, 717 (W.D. Penn. 1991).

If this Court were to accept certiorari and interpret 11 U.S.C. § 1129(b) as suggested by the Petitioner, Chapter 11 reorganization would be foreclosed as a realistic option for many business entities. Without the exception, the only option available for owners who want to preserve their ownership interest and continue their business is to pay dissenting unsecured creditors in full. In many cases that is an impossibility and, as a practical matter, there would be little incentive in most cases for business owners to undergo the cost and effort of a Chapter 11 reorganization under such constraints. *In re Pullman Construct. Indus., Inc.*, 107 Bankr. 909, 947, (N.D. Ill. 1989).

The purpose of Chapter 11 is to permit and to foster the successful rehabilitation of debtors. *NLRB v. Bildisco &*

Bildisco, 465 U.S. 513 (1984). The interpretation of § 1129(b) urged by Petitioner in this case would not promote the underlying purpose of Chapter 11. To the contrary, its adoption would significantly limit the use of Chapter 11. Both the district court and the Ninth Circuit Panel recognized this fact in their decisions. "In addition, the language of the Code must be read in light of the underlying bankruptcy principles. '[C]ontinued application of the new value exception comports with the policy underlying Chapter 11 reorganizations. The purpose of Chapter 11 is to successfully rehabilitate the debtor.' " See Opinion and Order of the District Court, Petition at A115-A116 (citations omitted).

Chapter 11 has two major objectives 1) to permit successful rehabilitation of debtors (citation omitted); and 2) to maximize the value of the estate (citation omitted). The new value exception, properly applied, serves both goals. By permitting prior stockholders to contribute new money in exchange for participation in the reorganized company, the debtor is given an additional source of capital. The new contribution increases the amount available for the estate to use both in its reorganization and in funding the plan and paying creditors. Without the inducement of participation in the reorganized debtor, the new money may be unavailable. (citation omitted). All parties involved, including the creditors, benefit from an increase in the assets of the estate. Judgment of the Ninth Circuit, Petition at A71-A72.

II. The Decision below is in accord with applicable decisions of this Court.

The Petitioner asserts that the court of appeals' decision conflicts both with this Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) and the line of this Court's decisions interpreting the Bankruptcy Code. The *Ahlers* case is the only Supreme Court case which has interpreted 11 U.S.C. § 1129(b). Contrary to the Petitioner's assertion, the *Ahlers* decision cannot be read as a comment, one way or the other, on the continued vitality of the new value exception.

We need not reach this question to resolve the instant dispute. As we discuss *infra*, at 204-206, 99 L. Ed. 2d, at 178-179, we think it clear that even if the *Los Angeles Lumber* exception to the absolute priority rule has survived enactment of the Bankruptcy Code, this exception does not encompass respondents' promise to contribute their "labor, experience, and expertise" to the reorganized enterprise.

Thus, our decision today should not be taken as any comment on the continuing vitality of the *Los Angeles Lumber* exception – a question which has divided the lower courts since the passage of the Code in 1978.

485 U.S. at 203, n.3.

The Petitioner's assertion that the court of appeals' decision in the *Bonner Mall* conflicts with this Court's approach to resolution of conflicts between pro-Code judicially-created rules and the Bankruptcy Code is also in error. The Petitioner's statement that the court of appeals' decision conflicts with *Dewsnup* is especially

incongruous in light of the Fifth Circuit's decision in *Greystone*. The original Fifth Circuit opinion specifically held that the new value exception to the absolute priority rule did not survive the enactment of the Bankruptcy Code. See 948 F.2d 134, 142-44 (5th Cir. 1991). After this Court released its decision in *Dewsnup*, the Fifth Circuit withdrew that portion of its opinion addressing the new value exception. See 955 F.2d 1274, 1284-85.

The absolute priority rule has been recognized by this Court since before the turn of the century. By 1913, the absolute priority rule was a "fixed principle." *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482 (1913). Another fixed principle prior to the enactment of the Bankruptcy Act was that capital is an essential ingredient for a successful reorganization and that it may be impossible to obtain unless the existing equity holders are permitted to contribute and retain an interest in the reorganized debtor. *Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).

Before the Supreme Court could reach a decision in *Case v. Los Angeles Lumber*, it was first called upon to decide whether Congress had adopted the absolute priority rule as part of the Bankruptcy Act. The statute merely required that a plan be "fair and equitable" as a condition of confirmation. It did not mention the absolute priority rule. The Court determined that the term "fair and equitable" had acquired a fixed meaning within the law and applied the rule of statutory construction that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary. *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 115 (1939). This Court

thus concluded that even though the Bankruptcy Act did not mention either the absolute priority rule or any exception to the rule, Congress had intended to incorporate both the rule and the exception when it adopted the Bankruptcy Act. *Id.* at 117.

The same reasoning applies to the 1978 Bankruptcy Code. When Congress used the words "fair and equitable" in section 1129 of the Code, it was with the express knowledge that this Court had held in 1939 that the phrase "fair and equitable" was a term of art with an established meaning which included both the absolute priority rule and the new value exception.

Congressional silence regarding codification of the new value exception cannot be interpreted as eliminating a substantial, judicially-created exception to the absolute priority rule. *In re: SLC Limited V*, 22 Bankr. Ct. Dec. 1081 (D. Utah 1992).

The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. (citation omitted) The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.

Midlantic National Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 501 (1986).

The most recent Supreme Court authority on this issue reaffirms the significance of bankruptcy practice prior to the passage of the Code and underscores this Court's unwillingness to interpret the Bankruptcy Code

in a manner contrary to pre-Code practice. *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903.

The issue before the Court in *Dewsnup* was whether a debtor pursuant to 11 U.S.C. § 506(d) could strip down a creditor's lien on real property to the judicially determined value of the collateral. This Court focused on pre-Code law to hold that § 506(d) does not allow a debtor to strip down a lien on real property. *Dewsnup* stands for the proposition that terms used in the Bankruptcy Code must be construed in a manner that is consistent with pre-Code practice.

When Congress amends the bankruptcy laws, it does not write "on a clean slate" (citation omitted). Furthermore this Court has been reluctant to accept arguments that would interpret the Code however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.

502 U.S. at ___ 112 S. Ct. at 779 (citations omitted). The court of appeals' decision in the *Bonner Mall* is fully consistent with *Dewsnup* and with long standing principles of statutory construction.

III. The Decision below is not in direct conflict with any other circuit level authority.

Both the eighth and the sixth circuits have held that the new value doctrine exists. *In re Anderson*, 913 F.2d 530 (8th Cir. 1990) (affirmed district court's conclusion that

debtors failed to meet their burden of showing a contribution that could be recognized under the new value exception.); *In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986) (assumed the survival of the new value exception). The Seventh Circuit, while expressing approval for the rule in *dicta*, recently declined for the third time to rule on the continued viability of the doctrine.

The debtors ask us to hold that the new value exception remains viable under the 1978 Code, while Farm Credit asks us to hold that it has vanished. We stop short of both parties' requests, as we did in *Kahm & Nate's Shoes and Stegall*, and as the Supreme Court did in *Ahlers*. We conclude instead that, assuming the new value retains its vitality, the Debtors' proposed contribution fails to meet its requirements. We therefore again reserve the issue the new value exception's continued viability for another day.

Snyder v. Farm Credit Bank of St. Louis, 967 F.2d 1126, 1130-31 (7th Cir. 1992).

The Seventh Circuit did recognize that the majority view favors the viability of the exception and expressed its general agreement with that view, however. *Id.* at 1129.

Opponents of the continued vitality of the new value exception have pointed to the language of the 1978 Code, in particular the codification of the absolute priority rule without any explicit exception for new value. (citations omitted) But their approach seems to slight a settled canon of interpretation: "If Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of

bankruptcy codifications." (citations omitted) This year the Court further explained: "When Congress amends the bankruptcy laws, it does not write 'on a clean slate.' Furthermore, this Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history. (citations omitted).

There is nothing in either the text or the legislative history of 1129(b) that can be said to demonstrate clear intent to modify seventy-five years of judicial construction of the absolute priority doctrine or its new value exception. The mere fact that Congress did not separately codify the exception does not establish its elimination for Congress is presumed to have been aware of the courts' interpretation of the contours of the absolute priority rule when it codified the rule. (citations omitted).

Id. at 1129.

The Fifth Circuit is the only circuit court which has issued a ruling holding that the exception does not exist. *In re Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991). On rehearing, however, the panel withdrew the portion of the majority opinion which dealt with the new value exception. See 995 F.2d 1274, 1284-85 (5th Cir. 1992). The Fifth Circuit's self-reversal on the new value exception appears to have been based, at least in part, on the recent Supreme Court decision in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), in which this Court held that Bankruptcy Code provisions must be

interpreted in light of pre-Code practices. See *Greystone*, 995 F.2d at 1284-85 (Jones, J., dissenting from withdrawal); *Snyder v. Farm Credit Bank of St. Louis*, 967 F.2d 1126, 1129.

The majority of the lower courts which have addressed the issue have also held that the doctrine retains its viability under the 1978 Code. See, e.g., *In re Tallahassee Associates, L.P.*, 132 Bankr. 712, 717 (W.D. Penn. 1991) (citations omitted); *Snyder v. Farm Credit Bank of St. Louis*, 99 Bankr. 885, 888 (C.D. Ill. 1989). There is no conflict between the circuits and thus no need for Supreme Court review.

CONCLUSION

This Court should only grant a petition for writ of certiorari when a United States court of appeals has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; has decided a federal question in a way that conflicts with applicable decisions of this Court; or when the case involves an important question of federal law which has not been, but should be, settled by this Court. Rule 10, Rules of the Supreme Court (Jan. 1, 1990).

The Ninth Circuit's decision is in accord with the majority position; is not in conflict with any other circuit level authority; and follows the most recent decisions of

this Court interpreting the Bankruptcy Code. The decision should not be reviewed.

Respectfully submitted,

BARBARA BUCHANAN
JOHN FORD ELSAESSER, JR.
ELSAESSER, JARZABEK &
BUCHANAN, CHTD.
123 S. Third Street
P.O. Box 1049
Sandpoint, ID 83864
(208) 263-8517

Counsel for Respondent

APPENDIX

Vol. 91, No. 84
IN THE UNITED STATES BANKRUPTCY
COURT FOR THE DISTRICT OF IDAHO
Cite as: 91 IBCR 187

In re:
BONNER MALL PARTNERSHIP,
Debtor.

Case No. 91-00801-11
MEMORANDUM OF DECISION

Ford Elsaesser and Barbara Buchanan, ELSAESER, JAR-ZABEK, BUCHANAN & DRESSEL, Sandpoint, Idaho, and Jerome Shulkin, SHULKIN, HUTTON & BUCKNELL, Seattle, Washington, for debtor.

Dale G. Higer and Thomas R. Linville, EBERLE, BERLIN, KADING, TURNBOW & McKLVEEN, Boise, Idaho, for U.S. Bancorp Mortgage Company.

HONORABLE ALFRED C. HAGAN, U.S. BANKRUPTCY JUDGE

U.S. Bancorp has moved for relief from the Section 362 automatic stay and to dismiss the debtor's chapter 11 petition.

After a hearing, it appears the granting of either motion depends on the ability of the debtor to formulate and obtain confirmation of a plan of reorganization under the statutory provisions of Chapter 11 of Title 11 of the United States Code. If it is apparent the debtor cannot obtain confirmation of a chapter 11 plan in accordance

with its purposes of reorganization, stay relief is appropriate under the *Timbers* decision of the United States Supreme Court¹ and dismissal would be appropriate under the provisions of 11 U.S.C. § 1112(1) or (2).

Considering the motion for stay relief, as it is possible for the Bank to be adequately protected pending the filing of a chapter 11 plan through adequate protection payments and the Bank is presently collecting the rents, since the property involved is the property sought to be reorganized, and since no other ground for cause for stay relief has been shown by the Bank to exist under the provisions of Section 362(d)(1), the issues are dependent on the prospective ability of the debtor to formulate a plan.

The dilemma the debtor faces is the requirement, recognized by the *Timbers* decision, a chapter 11 debtor must have a realistic prospect of an effective reorganization.

Section 362(d)(2) also belies petitioner's contention that undersecured creditors will face inordinate and extortionate delay if they are denied compensation for interest lost during the stay as part of "adequate protection" under § 362(d)(1). Once the movant under § 362(d)(2) establishes that he is an undersecured creditor, it is the burden of the *debtor* to establish that the collateral at issue is "necessary to an effective reorganization". See § 362(g). What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but that the property is essential for an effective reorganization *that is in prospect*. This means, as many lower courts,

including the en banc court in this case, have properly said, that there must be "a reasonable possibility of a successful reorganization within a reasonable time." 808 F.2d, at 370-371, and nn. 12-13, and cases cited therein. The cases are numerous in which § 362(d)(2) relief has been provided within less than a year from the filing of the bankruptcy petition. And while the bankruptcy courts demand less detailed showings during the four months in which the debtor is given the exclusive right to put together a plan, see 11 U.S.C. §§ 1121(b), (c)(2), even within that period lack of any realistic prospect of effective reorganization will require § 362(d)(2) relief. (Footnotes omitted)²

Under the provisions of 11 U.S.C. § 1129(b), since the Bank is an undersecured creditor, the Bank would most likely be in a position to block acceptance of any proposed plan of reorganization which contains an impairment of its secured claim.³ The Bank is definitely undersecured. The property sought to be reorganized, the Bonner Mall, is valued by the Bank at \$3.8 million and by the debtor at \$2.4 million. The Bank's claim is \$6.3 million. The debtor's scheme of reorganization depends upon the reduction of the Bank's claim to the value of the security. It is thus difficult to envision how the debtor will be able to obtain confirmation of a plan under the chapter 11 statutory requirements, nevertheless, the debtor's contentions will be considered.

Counsel for the debtor contends other unsecured creditors exist who would affect the plan acceptance provisions of 11 U.S.C. § 1126(c), including the claims of the individual partners who comprise the debtor limited partnership. However, the debtor's schedules indicate the

only other unsecured claims are \$62,178.00 owing to the Magnuson Children Trusts and a priority tax claim of Bonner County of \$195,500.00.

Counsel for the debtor further contends it may be possible to obtain confirmation of a plan by providing for separate classes of unsecured debt. Yet, under the provisions of 11 U.S.C. § 1129(a)(8), each class of impaired claims or interests must accept the plan. Otherwise, the provisions of Section 1129(b) apply and the debtor would be required to pay the unsecured claim of the Bank in full under the absolute priority rule provisions of Section 1129(b).

Lastly, counsel for the debtor argues there exists a possibility of a successful reorganization since Harry Magnuson intends to contribute additional capital. An exception to the absolute priority rule exists in the form of "infusion of new capital", commonly called the *Los Angeles Lumber* exception.⁴ Simply stated, the debtor can retain an interest in the chapter 11 estate ahead of creditors to the extent new capital is put into the estate by the debtor. However, the *Los Angeles Lumber* case, and cases decided since, have developed requirements for the exception. One of the requirements, and the most demanding, is the requirement the debtor contribute capital "reasonably equivalent" to the interest retained.⁵ The value is the fair market value of the property retained, valued at the time of confirmation.⁶

While it is doubtful neither the debtor, nor the members of the debtor partnership, intend to contribute capital to the extent required under the infusion of new

capital doctrine, discussion of the subject requires a determination of the value of the Mall.

In arriving at a proper value for the Bonner Mall, problems are posed by both appraisals. The debtor's appraisal of \$2.4 million was based only on an income approach. The income approach does not take into consideration the occupancy potential of the Mall but considers only the poor occupancy status which presently exists. Yet the Bank's appraisal moves too far in the opposite direction, taking into consideration market value comparisons with successful malls in different localities which make comparable adjustments extremely difficult. The Bank's appraisal is further suspect in the computation of the income approach considering the basic data used and the capitalization rate used.

While the debtor is appealing the \$3.2 million assessed valuation figure of the Bonner County Tax Assessor, this figure appears to be more realistic than either the debtor's or the Bank's respective valuation. Accordingly, the value of the Bonner Mall is thus found to be \$3.2 million, based on the evidence presented at this hearing.

The debtor will be allowed thirty (30) days to file a chapter 11 reorganization plan and disclosure statement which is not subject to rejection as a matter of law. If no plan is filed within the thirty day period, both the Bank's motions will be granted without further hearing, under the provisions of Sections 1112(b)(1) and (2) and 362(d)(2) respectively, upon presentation of an appropriate order or orders by counsel for the Bank. If a plan is filed, its potential for confirmation may be considered by notice

and hearing, with reduced time requirements if necessary, on motion of the Bank, otherwise the Bank's motions will be denied.

It is further found the debtor has not been guilty of unreasonable delay under the provisions of Section 1112(b)(3) and no bad faith exists on the part of the debtor or the individual partners of the debtor.

The debtor's motion for use of cash collateral to require the Bank to apply \$5,000.00 per month of the Yokes rentals on the \$905,000.00 loan will be denied. The funds are sought to be used not by the debtor-in-possession, but are intended to be used in payment of a debt other than a debt of the debtor. While unquestionably the debtor benefitted from the series of transactions which brought the "Yoke's" store into the Mall, the funds are presently being used more appropriately as part of the Bank's adequate protection.

The contents of this decision shall constitute formal findings of fact, conclusions of law and applicable orders.

IT IS SO ORDERED.

¹ *United Savings Assn. v. Timbers of Inwood Forest*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed. 2d 740 (1988).

² *United Savings Assn. v. Timbers of Inwood Forest*, 484 U.S. at 375, 376.

³ *In re South Village Inc.*, 25 B.R. 987 (Bankr. D. Utah 1982) and *Matter of DRW Property Co.* 82, 57 B.R. 987 (Bankr. N.D. Tex. 1986).

⁴ *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986); Polen and Wuhrman, the new value exception to the absolute priority rule, 93 Comm. L.J. 303; *In re Henke*, 90 B.R. 451 (Bankr.Mt. 1988); *Matter of Yasparro*, 100 B.R. 91 (Bankr. M.D. Fla. 1989).

⁵ *Case v. Los Angeles Lumber Products Co.*, 308 U.S. at 122, 60 S.Ct. at 10, 84 L.Ed. at 123. *In re Potter Material Service, Inc.*, 781 F.2d at 103. *Matter of Yasparro*, 100 B.R. at 97, 98.

⁶ *Matter of Yasparro*, 100 B.R. at 99.

(3) Supreme Court, U.S.
FILED
DEC - 3 1993
OFFICE OF THE CLERK

No. 93-714

IN THE
Supreme Court of the United States

OCTOBER TERM, 1993

U.S. BANCORP MORTGAGE COMPANY,

Petitioner.

vs.

BONNER MALL PARTNERSHIP,

Respondent.

**BRIEF OF AMICUS CURIAE
THE AMERICAN COUNCIL OF LIFE INSURANCE
IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

Of Counsel:

RICHARD E. BARNSBACK
PHILLIP E. STANO
DAVID M. LEIFER

American Council of Life Insurance
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2599
(202) 624-2183

ROBERT B. MILLNER

(Counsel of Record)

LORIE A. CHAITEN

Sonnenschein Nath & Rosenthal
8000 Sears Tower
233 S. Wacker Drive
Chicago, Illinois 60606-6404
(312) 876-8000

Counsel for Amicus Curiae
The American Council
of Life Insurance

26 pp

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iii
INTEREST OF AMICUS CURIAE	1
SUMMARY OF ARGUMENT	3
REASONS FOR GRANTING THE WRIT	4

THE NEW VALUE EXCEPTION IS AN IMPORTANT UNSETTLED QUESTION OF FEDERAL LAW. THERE IS A CONFLICT IN DECISIONS OF COURTS OF APPEAL AND AMONG MANY LOWER COURTS AS TO ITS EXISTENCE AND CONTENT. THERE IS A PERCEIVED CONFLICT BETWEEN DECISIONS OF THIS COURT AS TO THE APPROPRIATE APPROACH TOWARD CONSTRUCTION OF THE BANKRUPTCY CODE, PARTICULARLY WITH REGARD TO PRE-CODE PRACTICE. EXISTENCE OF A NEW VALUE EXCEPTION IS CONTRARY TO THE EXPRESS LANGUAGE OF THE BANKRUPTCY CODE. THE EXCEPTION ARTICULATED BY THE NINTH CIRCUIT IS UNWORKABLE AND INCAPABLE OF CONSISTENT APPLICATION, ESPECIALLY IN SINGLE ASSET REAL ESTATE CASES LIKE THE INSTANT CASE

TABLE OF CONTENTS - Continued

	Page
A. There Is A Need For Supreme Court Review To Resolve Conflicts Among Decisions By Courts Of Appeal And Lower Courts As Well As A Widely Perceived Conflict Between Decisions Of This Court	5
1. Under <i>Ron Pair</i> , The Code's Clear Statutory Language Should Control	7
2. Authoritative Guidance Is Needed As To The Role Of Varying Pre-Code Reorganization Practices In Chapter 11 Interpretation	10
B. The New Value Exception Is Unworkable And Incapable Of Consistent Application, Especially In Single Asset Real Estate Cases	15
CONCLUSION	17

TABLE OF AUTHORITIES

	Page
Cases:	
<i>In re A.V.B.I., Inc.</i> , 143 B.R. 738 (Bankr. C.D. Cal. 1992)	9, 12, 15
<i>In re Bjolmes Realty Trust</i> , 134 B.R. 1000 (Bankr. D. Mass. 1991)	6
<i>In re Bonner Mall Partnership</i> , 2 F.3d 899 (9th Cir. 1993)	<i>passim</i>
<i>In re Bryson Properties, XVIII</i> , 961 F.2d 496 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992)	5, 9
<i>Case v. Los Angeles Lumber Prods. Co.</i> , 308 U.S. 106 (1939)	12, 13, 14
<i>Dewsnup v. Timm</i> , 502 U.S. ___, 112 S. Ct. 773 (1992)	5, 6, 9, 10, 14
<i>In re Greystone III Joint Venture</i> , 995 F.2d 1274 (5th Cir. 1991)	5
<i>Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting</i> , 908 F.2d 1351 (7th Cir. 1990)	5, 9, 13
<i>In re Lumber Exch. Bldg. Ltd. Partnership</i> , 125 B.R. 1000 (Bankr. D. Minn.), aff'd on other grounds, 134 B.R. 354 (D. Minn. 1991), aff'd, 968 F.2d 647 (8th Cir. 1992)	9
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988)	2, 3

TABLE OF AUTHORITIES - Continued

	Page
<i>In re One Times Square Assocs. Ltd. Partnership</i> , No. 92 B 41471, 1993 Bankr. LEXIS 1553 (Bankr. S.D.N.Y. Oct. 15, 1993)	6
<i>In re Outlook/Century Ltd.</i> , 127 B.R. 650 (Bankr. N.D. Cal. 1991).....	9
<i>Pennsylvania Dep't of Pub. Welfare v. Davenport</i> , 495 U.S. 552 (1990).....	11
<i>In re S.A.B.T.C. Townhouse Ass'n, Inc.</i> , 152 B.R. 1005 (Bankr. M.D. Fla. 1993)	6
<i>In re SM 104 Ltd.</i> , No. 92-22698-BKC-AJC, 1993 Bankr. LEXIS 1352 (Bankr. S.D. Fla. Sept. 15, 1993)	6, 15, 16
<i>In re Snyder</i> , 967 F.2d 1126 (7th Cir. 1992)	5, 6
<i>Toibb v. Radloff</i> , 111 S.Ct. 2197 (1991)	7
<i>United States v. Ron Pair Enters., Inc.</i> , 489 U.S. 240 (1989)	5, 6, 7, 9
Statutes:	
<i>Bankruptcy Act of 1898</i> , 11 U.S.C. <i>et seq.</i> (repealed 1979):	
Ch. X, 11 U.S.C. § 501 <i>et seq.</i>	11, 12
Ch. X, § 221 (formerly codified as amended at 11 U.S.C. § 621)	12
Ch. XI, 11 U.S.C. § 701 <i>et seq.</i>	11, 12
Ch. XII, 11 U.S.C. § 801	11

TABLE OF AUTHORITIES - Continued

	Page
Bankruptcy Code , 11 U.S.C. § 101 <i>et seq.</i> :	
11 U.S.C. § 506(a)	16
11 U.S.C. § 506(b)	6
11 U.S.C. § 506(d)	6
11 U.S.C. §§ 1107, 1108	12
11 U.S.C. §§ 1211(b)-(c)	11
11 U.S.C. § 1129	<i>passim</i>
11 U.S.C. § 1129(a)(8)(A)	12, 13
11 U.S.C. § 1129(b)(1).....	2, 7
11 U.S.C. § 1129(b)(2).....	16
11 U.S.C. § 1129(b)(2)(B)	2, 7, 8
11 U.S.C. § 1129(b)(2)(B)(ii)	5
Other Authorities:	
American Council of Life Insurance, <i>Life Insurance Fact Book</i> 84-103 (1992)	1
American Council of Life Insurance, <i>1993 Fact Book Update</i> 46-54 (1993)	1

TABLE OF AUTHORITIES - Continued

	Page
John T. Bailey, <i>The "New Value Exception" in Single Asset Reorganizations: A Commentary on the Bjolmes Auction Procedure and Its Relationship to Chapter 11</i> , 98 Com. L.J. 50 (1993)	14
Douglas G. Baird, <i>The Elements of Bankruptcy</i> (1992)	2, 15
5 <i>Collier on Bankruptcy</i> (Lawrence P. King ed., 15th ed. 1993)	11, 12
3 David G. Epstein <i>et al.</i> , <i>Bankruptcy</i> (1992)	8, 14
Bruce A. Markell, <i>Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations</i> , 44 Stan. L. Rev. 69	12
Stephen W. Sather & Adrian M. Overstreet, <i>The Single Asset Debtor: A Selective Overview</i> , 2 J. Bankr. L. Prac. 343 (1993)	12
Elizabeth Warren, <i>A Theory of Absolute Priority</i> , 1991 Ann. Surv. Am. L. 9 (1992)	2
Lisa Hill Fenning <i>et al.</i> , <i>Good Faith: Roundtable Discussion</i> , 1 Am. Bankr. Inst. L. Rev. 11 (1993)	15

BRIEF OF AMICUS CURIAE THE AMERICAN COUNCIL OF LIFE INSURANCE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

This Brief, in support of the Petition for a Writ of Certiorari, is submitted in accordance with Rule 37 of the Rules of this Court and pursuant to the attached written consent of all parties.

INTEREST OF AMICUS CURIAE

Amicus, the American Council of Life Insurance ("ACLI"), is the principal national trade association of life insurers. ACLI's 634 member companies account for 90% of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1992, life companies' net investment in U.S. capital markets totaled \$107.3 billion — ranking second (only after mutual funds) among private domestic capital sources.¹

The interest of the ACLI as *amicus* arises out of the signal importance the decision below has to the commercial lending community. As a principal source of investment capital in the United States, life insurance companies have a broad and important perspective on the reasons why Supreme Court review is needed here.

The question of existence and content of a new value exception to the absolute priority rule in bankruptcy is one of the most important issues of bankruptcy law today. The absolute priority rule lies at the heart of corporate law and bankruptcy

¹ American Council of Life Insurance, *1993 Fact Book Update* 46-54 (1993); see also American Council of Life Insurance, *Life Insurance Fact Book* 84-103 (1992).

reorganization.² It sets forth the fundamental ordering of rights and priorities between equity owners and creditors and "sets the ground rules of Chapter 11."³

The absolute priority rule was expressly codified, *without exception*, in Section 1129(b)(2)(B)(ii) of the Bankruptcy Reform Act of 1978 (the "Bankruptcy Code"), 11 U.S.C. § 101 *et seq.* This rule is part of the Code's requirement that a reorganization plan be "fair and equitable" in order to be confirmed over objection of a creditor class. 11 U.S.C. § 1129(b)(1). The absolute priority rule provides that the debtor must pay a nonconsenting class of unsecured creditors in full or "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. § 1129(b)(2)(B).

The decision below deals a dramatic blow to the rule of absolute priority. It not only (a) upholds the existence of a "new value" exception by which old equity, despite objection by an impaired creditor class, may purchase ownership of the reorganized debtor, but (b) more sweepingly holds that old equity can be granted an *exclusive* right to purchase that ownership on terms it sets without competitive bid or counter-proposal.

Life insurance companies, like all lenders, presently are faced with conflicting rules as to the existence and application of a new value exception to the absolute priority rule. The bankruptcy courts, district courts and courts of appeal are divided, as is the abundant scholarship on the subject. The present legal morass consists, at least in part, of different judicial responses to the Court's statements in *Norwest Bank Worthington v. Ahlers*, 485

U.S. 197 (1988).⁴ Lenders are thus faced with significant uncertainty.

Lenders price loans and bargain for security and other terms based on risks of nonpayment and potential for recovery in the event of default. Lenders (and borrowers) need a uniform national rule of bankruptcy distribution priorities and a rule capable of consistent application. Particularly in these difficult economic times, uncertainty as to the fundamental compact between debt holders and equity — *i.e.*, an understanding as to rights and priorities in the event of insolvency — serves to make loan money and other credit less available. Such uncertainty also serves to make difficult or impossible consensual workouts, which can obviate the need for bankruptcy or any judicial intervention. Review of the decision below is thus vitally important to the ACLI and its members.

SUMMARY OF ARGUMENT

The statutory absolute priority rule, and the existence and terms of an extra-statutory exception, is a recurring matter badly in need of the Supreme Court's authoritative voice. Review is necessary because of: (i) the fundamental significance of the absolute priority rule; (ii) the conflict in decisions of the courts of appeal and among many lower courts as well as the perceived conflict between two recent decisions of this Court; (iii) the need for a uniform national rule; (iv) the need for a workable rule capable of consistent application; and (v) the need for the Court

² See Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L. 9 (1992).

³ Douglas G. Baird, *The Elements of Bankruptcy* 73 (1992).

⁴ In *Ahlers* the Court expressly declined to reach the question of whether a new value exception exists, although urged to do so by the United States as *amicus curiae*. *Ahlers*, 485 U.S. at 203 n.3. The Court recognized, however, that the vitality of the exception is "a question which has divided the lower courts since passage of the Code in 1978." *Id.* Since *Ahlers*, the debate over new value and absolute priority has continued, without consensus (except as to need for Supreme Court review).

to provide a consistent approach to construction of the Bankruptcy Code.

REASONS FOR GRANTING THE WRIT

THE NEW VALUE EXCEPTION IS AN IMPORTANT UNSETTLED QUESTION OF FEDERAL LAW. THERE IS A CONFLICT IN DECISIONS OF COURTS OF APPEAL AND AMONG MANY LOWER COURTS AS TO ITS EXISTENCE AND CONTENT. THERE IS A PERCEIVED CONFLICT BETWEEN DECISIONS OF THIS COURT AS TO THE APPROPRIATE APPROACH TOWARD CONSTRUCTION OF THE BANKRUPTCY CODE, PARTICULARLY WITH REGARD TO PRE-CODE PRACTICE. EXISTENCE OF A NEW VALUE EXCEPTION IS CONTRARY TO THE EXPRESS LANGUAGE OF THE BANKRUPTCY CODE. THE EXCEPTION ARTICULATED BY THE NINTH CIRCUIT IS UNWORKABLE AND INCAPABLE OF CONSISTENT APPLICATION, ESPECIALLY IN SINGLE ASSET REAL ESTATE CASES LIKE THE INSTANT CASE.

ACLI's Statement of Interest sets forth the singular importance of the matter at hand and the need for a uniform national rule as to absolute priority. This Court should provide such a rule.

A. There Is A Need For Supreme Court Review To Resolve Conflicts Among Decisions By Courts Of Appeal And Lower Courts As Well As A Widely Perceived Conflict Between Decisions Of This Court.

The conflict in decisions between and within the courts of appeal, as well as the widespread conflict among lower courts, is described at pages 13-16 of the Petition for Writ of Certiorari.⁵ Of equal importance is the perceived conflict between two recent decisions by this Court as to the appropriate approach toward construction of the Bankruptcy Code and, in particular, the impact of pre-Code practice. Those decisions are *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773 (1992), and *United States v. Ron Pair Enters., Inc.*, 489 U.S. 240 (1989).

⁵ The decision below squarely conflicts with the Fourth Circuit's decision in *In re Bryson Properties*, XVIII, 961 F.2d 496 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992). While the Fourth Circuit in *Bryson* did not rule on the existence *vel non* of a new value exception, it did hold that a reorganization plan that gives old equity alone the right to retain an interest in the reorganized debtor violates 11 U.S.C. § 1129(b)(2)(B)(ii). *Id.* at 504-05. In the decision below, the Ninth Circuit expressly rejected *Bryson* and held that such new value plans are confirmable. *In re Bonner Mall Partnership*, 2 F.3d 899, 910 (9th Cir. 1993).

Moreover, statements from the Seventh Circuit show internal division in that Circuit. In *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361 (7th Cir. 1990), the court stated that "[t]he language of the Code strongly suggests" that the new value exception is not viable. In a more recent decision, *In re Snyder*, 967 F.2d 1126, 1129 (7th Cir. 1992), a different Seventh Circuit panel advised that there are strong reasons to believe the new value exception is viable. In *In re Greystone III Joint Venture*, 995 F.2d 1274 (5th Cir. 1991), the Fifth Circuit first found that new value was not a viable exception to the absolute priority rule; however, on rehearing the court reversed itself and vacated its earlier opinion as it applies to the new value exception. It now expresses "no view whatever" on the new value exception. *Id.* at 1284.

Dewsnup held, in the context of a Chapter 7 case, that Section 506(d) of the Code does not allow a debtor to strip down a mortgage when the property is abandoned. In *Dewsnup*, the Court stressed the primacy of pre-Code practice in construing the Code, noting that “[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate.” *Dewsnup*, 112 S. Ct. at 779 (citation and internal quotation marks omitted). *Dewsnup* advises lower courts to incorporate pre-Code bankruptcy concepts unless “convinced that Congress intended to depart from the pre-Code rule.” *Id.* at 778. The decision below relied heavily on *Dewsnup*. 2 F.3d at 912-13.⁶

Ron Pair, by contrast, stressed natural interpretation of statutory language. Based on the statutory text, *Ron Pair* held that Section 506(b) of the Bankruptcy Code requires that post-petition interest be allowed on nonconsensual oversecured prepetition claims. The Court directed that “the plain meaning of legislation should be conclusive, except in the rare cases [in

footnote continued from page 6

Added to the confusion is disagreement as to the terms of the exception, if it exists. For example, some cases, like the decision of the Ninth Circuit below, hold that old equity’s right to purchase ownership can be exclusive and need not be subjected to competitive bidding; other cases hold that the exception requires that an auction be held. See, e.g., *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1010 (Bankr. D. Mass. 1991).

Numerous recent lower court cases rejecting and adopting the new value exception are catalogued in *In re SM 104 Ltd.*, No. 92-22698-BKC-AJC, 1993 Bankr. LEXIS 1352, at *66-68 & nn. 40-41 (Bankr. S.D. Fla. Sept. 15, 1993).

⁶ Other lower courts similarly have relied on *Dewsnup* as a basis to import a new value exception into Chapter 11. See, e.g., *Snyder*, 967 F.2d at 1129; *In re One Times Square Assocs. Ltd. Partnership*, No. 92 B 41471, 1993 Bankr. LEXIS 1553, at *34-35 (Bankr. S.D.N.Y. Oct. 15, 1993); *In re S.A.B.T.C. Townhouse Ass’n, Inc.*, 152 B.R. 1005, 1009 (Bankr. M.D. Fla. 1993).

which] the literal application of a statute produces a result demonstrably at odds with the intentions of its drafters.” *Ron Pair*, 489 U.S. at 243 (citation and internal quotation marks omitted); *accord Toibb v. Radloff*, 111 S. Ct. 2197, 2199-2200 (1991).

This Court should establish a consistent approach to construction of Chapter 11 of the Bankruptcy Code.

1. Under *Ron Pair*, The Code’s Clear Statutory Language Should Control.

Whether or not a new value exception exists, and what the terms of such exception might be, are matters of statutory interpretation. Here the statute is the Bankruptcy Code. Under Section 1129(b)(1) of the Code, a plan can be confirmed over opposition of an impaired class, *i.e.*, by cramdown, only if it is “fair and equitable” with respect to that class.⁷ Under Section 1129(b)(2)(B), a plan must observe the absolute priority “requirement” in order to be “fair and equitable”:

(2) For the purpose of this subsection, the condition that a plan be *fair and equitable* with respect to a class includes the following requirements:

⁷ Section 1129(b)(1) provides:

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

* * *

(B) With respect to a class of unsecured claims —

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B) (emphasis added).⁸

The statute is clear. The condition that a plan be fair and equitable "includes" as a "requirement[]" the rule of absolute priority, *i.e.*, the unsecured class must be paid in full or junior classes receive nothing. 11 U.S.C. § 1129(b)(2)(B).

On its face, the Bankruptcy Code describes absolute priority as a *minimum* requirement for cramdown plan confirmation. The word *includes*, which precedes the listing of confirmation requirements, means that the courts can impose more

⁸ The debtor may pay creditors over time as long as the present value of the time payment at least equals the allowed amount of the claim. The property received by the creditors may be tangible or intangible, including securities of the debtor or a successor to the debtor under a plan of reorganization. 3 David G. Epstein *et al.*, *Bankruptcy* § 10-21 (1992).

requirements, not provide exceptions that eviscerate the minimum.⁹

The Ninth Circuit, specially relying on *Dewsnup*, found that the term *includes* "leaves room" for an exception to the plainly stated rule. 2 F.3d at 912. The court imported its view of pre-Code practice, *i.e.*, the new value exception, into the Code text because "the Code does not unambiguously abrogate" it and its legislative history does not "dictate[] a contrary result." *Id.* at 913.

Ron Pair teaches that natural interpretation of statutory language should control Code interpretation absent compelling reason to the contrary.¹⁰ Here there are no compelling reasons to override or eviscerate the statutory language. There is no suggestion in Section 1129, or in the Bankruptcy Code as a whole, that a new value exception exists. Moreover, nothing in

⁹ See *In re A.V.B.I., Inc.*, 143 B.R. 738, 743 (Bankr. C.D. Cal. 1992) (rejecting existence of new value exception); *In re Outlook/Century Ltd.*, 127 B.R. 650, 656 (Bankr. N.D. Cal. 1991) (rejecting existence of new value exception).

¹⁰ The Ninth Circuit also departed from the rule of natural interpretation of plain language when it held that old equity's exclusive right to purchase ownership of the reorganized debtor was not received or retained "on account of" its prior ownership interest in the debtor. 2 F.3d at 910. An exclusive right to purchase ownership constitutes property. *Bryson*, 961 F.2d at 504; *Kham and Nate's*, 908 F.2d at 1360. The only reason old equity is able to obtain this special purchase option is because of its pre-petition ownership of the debtor. *Id.*; accord *Outlook/Century*, 127 B.R. at 654; *In re Lumber Exch. Bldg. Ltd. Partnership*, 125 B.R. 1000, 1008 (Bankr. D. Minn.), *aff'd on other grounds*, 134 B.R. 354 (D. Minn. 1991), *aff'd*, 968 F.2d 647 (8th Cir. 1992).

the legislative history suggests a Congressional intention to enact a new value exception.¹¹

2. Authoritative Guidance Is Needed As To The Role Of Varying Pre-Code Reorganization Practices In Chapter 11 Interpretation.

In the wake of *Dewsnup*, the lower courts have not adequately focused on the danger of holding that old case law, arising under a different statutory scheme, should control interpretation of the Bankruptcy Code. Moreover, none of the cases cited in the decision below, including *Dewsnup*, analyzes, or even adverts to, the advisability of incorporating single elements of pre-Code

¹¹ In urging the Court in *Ahlers* to rule that there is no new value exception, the Solicitor General emphasized:

*Nothing in the legislative history suggests a congressional intention to maintain the exception discussed in *Los Angeles Lumber*. The House report, in describing proposed Section 1129(b), states: "The general principle of the subsection permits confirmation notwithstanding non-acceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. The dissenting class must be paid in full before any junior class may share under the plan." H.R. Rep. 95-595, *supra*, at 412. No exceptions to this rule seem to be contemplated.*

Brief for the United States as *Amicus Curiae* Supporting Petitioners, *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (No. 86-958) (hereinafter "Solicitor General's Brief in *Ahlers*") at 21 (emphasis added) (footnotes omitted).

reorganization law into the complex matrix of checks and balances that constitute Chapter 11.¹²

Chapter 11 was enacted in 1978 as a comprehensive overhaul of federal reorganization law. The three reorganization chapters of the old Bankruptcy Act of 1898, Chapter X (large business reorganizations), Chapter XI (small business reorganizations), and Chapter XII (real estate reorganizations), were combined into a single, new Chapter 11. 5 *Collier on Bankruptcy* (Lawrence P. King ed., 15th ed. 1993) (hereinafter "*Collier on Bankruptcy*") ¶ 1100.01[2] at 1100-1108. Overall, dramatic changes were made in business reorganization cases.

Significant differences existed among each of the reorganization chapters of the old Act, as well as between reorganization practice generally under the old Act and current Chapter 11 practice. For example, in old Chapter X the debtor had no exclusive right to propose a plan.¹³ Instead, all persons *other than* the debtor could submit proposals for a plan to the trustee, and the debtor could not file a plan until the trustee's time to file had expired. 5 *Collier on Bankruptcy* ¶ 1100.01[1]. In contrast, under new Chapter 11 the debtor generally has an exclusive right to file a plan for at least 120 days after the date of the bankruptcy petition and 60 additional days to obtain its acceptance. See 11 U.S.C. §§ 1121(b)-(c).

¹² The Ninth Circuit cited the Court's decision in *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552 (1990), as support for a strong presumption in favor of importing pre-Code practices into the Code. 2 F.3d at 912 n.31. *Davenport*, however, relied on the Code's plain statutory language in the context of a Chapter 13 wage earner case to refuse "to carve out a broad judicial exception to discharge for [criminal] restitution orders." 495 U.S. at 563. Contrary to the Ninth Circuit's reading, the Court declined in *Davenport* to eviscerate statutory language in favor of a pre-Code practice against discharge of such obligations. *Id.*

¹³ Under old Chapter XI the debtor had the exclusive right to file a plan for the duration of the case. 5 *Collier on Bankruptcy* ¶ 1100.01[1].

Under Chapter X, a trustee, with power to operate the business and investigate all pertinent matters, was generally required, while in Chapter XI the debtor generally was permitted to remain in possession of its property and to conduct its business. *5 Collier on Bankruptcy* ¶ 1100.01[1]; see A.V.B.I., 143 B.R. at 743. Under new Chapter 11, the debtor ordinarily is allowed to remain in possession. 11 U.S.C. §§ 1107-08.¹⁴

In short, there was no singular pre-Code reorganization practice. Moreover, the new value exception arose in response to a problem under the old Act that does not arise under the Code. The Court's dicta in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), out of which the discussion of new value arises, related to a "holdout" problem unique to the old Bankruptcy Act. Under the Act, a plan could be confirmed only if it was "fair and equitable" to each dissenting creditor. See Bankruptcy Act of 1898, Ch. X, § 221 (formerly codified as amended at 11 U.S.C. § 621 (1978), repealed by Bankruptcy Code; Solicitor General's Brief in *Ahlers* at 14 n.13 (discussing old Chapter X and its predecessor, Section 77B). Not only was class acceptance required, but the plan had to observe absolute priority as to minority dissenting creditors of the same class. *Id.*

The present Code is different. The Bankruptcy Code permits a creditor class, by a class vote that overrides the objections of minority members, to assent to a plan that is not "fair and equitable," i.e., does not observe absolute priority. 11 U.S.C.

¹⁴ Chapter X had an absolute priority (fair and equitable) rule. However, absolute priority was deleted from Chapters XI and XII of the Act in 1952. Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 91-92 (1991); Stephen W. Sather & Adrian M. Overstreet, *The Single Asset Debtor: A Selective Overview*, 2 J. Bankr. L. Prac. 343-47 (1993).

§ 1129(a)(8)(A). "Holdouts that spoiled reorganizations and created much of the motive for having judges 'sell' stock to the manager-shareholders no longer are of much concern, now that § 1126(c) allows the majority of each class (two-thirds by value) to give consent." *Kham & Nate's*, 908 F.2d at 1361.¹⁵

To underscore the danger of importing old Act reorganization practice into the Bankruptcy Code, it is also important to note that the new value concept arose from dicta, not holding, in *Los Angeles Lumber*.¹⁶ Despite that dicta, the Court has never

¹⁵ Indeed, as noted by the Solicitor General in *Ahlers*, a substantial majority of bondholders had voted to accept the plan in *Los Angeles Lumber* and such bondholder consent would have been sufficient under the new Code consensually to confirm the plan under § 1129(a)(8)(A). Solicitor General's Brief in *Ahlers* at 14 n.13, 18 n.16.

¹⁶ *Los Angeles Lumber* was a case under Section 77B (predecessor to Chapter X) of the Bankruptcy Act, in which the Court rejected a reorganization plan that violated absolute priority. As to new value, the Court stated:

[T]his Court [has] stress[ed] the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made

¹⁷ U.S. at 121 (footnote omitted). The pre-Code new value exception as understood by the Ninth Circuit has the following five requirements:

Former equity owners were required to offer value that was 1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful reorganization and 5) reasonably equivalent to the value or interest received.

2 F.3d at 908 (citing *Los Angeles Lumber*, 308 U.S. 121-22).

adopted the new value exception in a case holding.¹⁷ As acknowledged in the decision below, prior to passage of the 1978 Code, the last time the new value exception was even adverted to by this Court was in 1946. 2 F.3d at 912. Commentators note that no reported decision adopted the *Los Angeles Lumber* dicta as holding prior to the Code's adoption in 1978. Markell, *supra*, at 92; John T. Bailey, *The "New Value Exception" in Single Asset Reorganizations: A Commentary on the Bjolmes Auction Procedure and Its Relationship to Chapter 11*, 98 Com. L.J. 50, 54 (1993). "New value" cramdowns were not established pre-Code practice.¹⁸

Holding pre-Code practice to be an overriding canon, warranting the incorporation of isolated pieces of pre-Code practice and dicta into the Bankruptcy Code, ultimately will result in havoc being played on the Chapter 11 statutory matrix. To the extent that *Dewsnup* is perceived to be a command to follow such canon, it should be limited by this Court.

¹⁷ Moreover, *Los Angeles Lumber* does not analyze the impact of an exclusivity concept (now operative in Chapter 11) on the new value dictum. Nor does it analyze the informational advantage, or potential for abuse, available to old equity when the debtor remains in possession and its owners are given the right to purchase the reorganized entity over the objection of impaired creditors.

¹⁸ Epstein, Nickles and White observed in 1992:

This wall, the absolute priority rule, has protected reorganization creditors quite effectively against debtors onslaught for nearly 80 years. However, in the past decade debtors have successfully breached the wall in a handful of cases under the banner of "new value."

³ Epstein, *supra*, §§ 11-25, at 134.

B. The New Value Exception Is Unworkable And Incapable Of Consistent Application, Especially In Single Asset Real Estate Cases.

At bottom, a new value exception is a judicial power to sell ownership of an insolvent entity to old equity over objection by impaired creditors, who may be receiving only a small fraction of the amounts owed them. Under the decision below, the price that old equity pays is the price it unilaterally sets, subject only to judicial upset.

The potential for abuse is enormous. Under present Chapter 11, old equity typically remains in possession. It has superior knowledge about the firm, i.e., an informational advantage over the bankruptcy judge and the creditors. See A.V.B.I., 143 B.R. at 743; Douglas G. Baird, *The Elements of Bankruptcy* 250 (1992). Old equity alone proposes and supports the price, the adequacy of which is not subject to the check of competitive bid.

The exception is most unworkable, and incapable of consistent application, in cases like this one, involving a debtor whose estate consists of a single commercial real estate asset.

Single asset cases comprise a substantial portion — in some districts as much as half — of all Chapter 11 filings. Lisa Hill Fenning *et al.*, *Good Faith: Roundtable Discussion*, 1 Am. Bankr. Inst. L. Rev. 11, 14-15 (1993). Typically, the asset — a small, office building or apartment building — is fully encumbered with mortgage debt. See *In re SM 104 Ltd.*, No. 92-22698-BKC-AJC, 1993 Bankr. LEXIS 1352, at *3 (Bankr. S.D. Fla. Sept. 15, 1993). In the case at hand, for example, the lender's claim was for \$6.6 million, and the collateral was valued at \$3.2 million —

yielding a secured claim of \$3.2 million and an unsecured deficiency claim of \$3.4 million. 2 F.3d at 899.¹⁹

Under Section 1129(b)(2), the mortgage lien will remain intact and survive the bankruptcy, at least to the extent of the value of the collateral. Even after bankruptcy discharge of the unsecured debt, the debtor's property will remain fully encumbered. At best, the equity value is "highly speculative."²⁰ A rule of law that overrides creditors' fundamental statutory priority based on such speculation is not susceptible of just or consistent application.

The issue before the Court is one of the most fundamental and important issues of bankruptcy law today. It is also one of the most unsettled. Allowing the matter to continue to fester in lower courts will serve no positive purpose and will harm the operation of domestic credit markets.

¹⁹ By virtue of Section 506(a) of the Code, the mortgagee has an unsecured deficiency claim for the amount by which the mortgage debt exceeds the value of the collateral.

²⁰ "In single asset real estate cases where the property is fully encumbered, the capitalized earnings value presumably has been entirely allocated to the valuation of the secured claim, as required by § 506 and the absolute priority rule. That leaves the question of how to value the highly speculative equity." See *SM 104*, 1993 Bankr. LEXIS 1352, at *92.

CONCLUSION

For the reasons stated herein and in the Petition for a Writ of Certiorari, the American Council of Life Insurance, as *amicus*, respectfully submits that the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

ROBERT B. MILLNER
(*Counsel of Record*)
LORIE A. CHAITEN
Sonnenschein Nath & Rosenthal
233 S. Wacker Drive
Suite 8000
Chicago, Illinois 60606-6401
(312) 876-8000

*Attorneys for Amicus Curiae,
the American Council of
Life Insurance*

Of Counsel:

RICHARD E. BARNSBACK
PHILLIP E. STANO
DAVID M. LEIFER
American Council of Life Insurance
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2599
(202) 624-2183

December 3, 1993

SONNENSCHEIN NATH & ROSENTHAL

8000 SEARS TOWER
CHICAGO, ILLINOIS 60606-6404
LOS ANGELES
NEW YORK
SAN FRANCISCO
ST. LOUIS
WASHINGTON, D.C.

(312) 976-6000
TELEFAX 28 3526
FACSIMILE
(312) 976-7834

Lorie A. Chaiten
(312) 976-6000

November 22, 1993

BY FEDERAL EXPRESS

Ford Elsaesser, Esq.
Elsaesser, Jarzabek, Buchanan
& Dressel
Lake Plaza Building
3rd and Lake Streets
Sandpoint, ID 83864

Re: Bonner Mall Partnership v. U.S. Bancorp Mortgage
Company

Dear Mr. Elsaesser:

On Friday, November 19, 1993, we spoke by telephone, and you provided your consent to the filing of a brief by The American Council of Life Insurance as *amicus curiae* in support of the Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit in the above-captioned matter. Pursuant to Supreme Court Rule 37, I am requesting that you sign, on the line provided below, to confirm in writing your consent to the filing of this *amicus* brief. After you have done so, please return this document to me.

Very truly yours,

SONNENSCHEIN NATH & ROSENTHAL

By: *Lorie A. Chaiten*
Lorie A. Chaiten

LAC/kh

Ford Elsaesser
Ford Elsaesser, attorney for
the Debtor

SONNENSCHEIN NATH & ROSENTHAL

8000 SEARS TOWER

CHICAGO, ILLINOIS 60606-6404

(312) 676-9000
TELEX 25-3526
FACSIMILE
(312) 676-7804

LOS ANGELES
NEW YORK
SAN FRANCISCO
ST. LOUIS
WASHINGTON, D.C.

Robert B. Millner
(312) 676-7804

November 23, 1993

BY FEDERAL EXPRESS

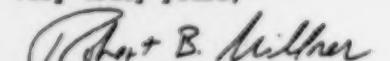
Bradford Anderson, Esq.
Stoel Rives Boley Jones & Grey
3600 One Union Square
600 University St.
Seattle, WA 98101-3197

Re: U.S. Bancorp Mortgage Company v. Bonner
Hall Partnership

Dear Mr. Anderson:

Please confirm, by signing below, that Petitioner U.S. Bancorp Mortgage Company consents to the filing of an amicus curiae brief by the American Council of Life Insurance in connection with the petition for writ of certiorari filed in the above-referenced case. The consent should be returned to my attention.

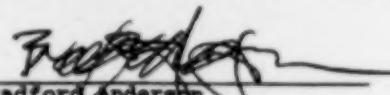
Very truly yours,



Robert B. Millner
Counsel for American Council
of Life Insurance

RBM/hlf/61544

CONSENT TO FILING OF AMICUS BRIEF:

By: 
Bradford Anderson
Counsel of Record For Petitioner
U.S. Bancorp Mortgage Company

FEB 24 1994

RECEIVED IN THE CLERK'S OFFICE

IN THE
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,

v.
BONNER MALL PARTNERSHIP,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JOINT APPENDIX

Bradford Anderson*

Dale G. Higer

David B. Levant

**Counsel of Record*

STOEL RIVES BOLEY

JONES & GREY

3600 One Union Square

600 University Street

Seattle, WA 98101-3197

(206) 624-0900

Counsel for Petitioner

Barbara Buchanan

John Ford Elsaesser, Jr.

Counsel of Record

ELSAESSER JARZABEK

& BUCHANAN, CHTD.

Third & Lake Streets

P.O. Box 1049

Sandpoint, ID 83864

(208) 263-8517

Counsel for Respondent

PETITION FOR CERTIORARI FILED NOVEMBER 2, 1993
CERTIORARI GRANTED JANUARY 10, 1994

378P

TABLE OF CONTENTS

	<u>Page</u>
Chronological List of Relevant Docket Entries	1
Memorandum of Decision of Bankruptcy Court, Dated August 23, 1991	Pet. App. A118
First Amended Plan of Reorganization, Dated October 29, 1991	2
Memorandum of Decision of Bankruptcy Court, Dated December 6, 1991	29
Opinion and Order of District Court, Dated July 15, 1992	Pet. App. A90
Correction Order of District Court, Dated July 23, 1992	Pet. App. A88
Notice of Appeal, Dated August 14, 1992	Pet. App. A85
Opinion and Order of Court of Appeals, Dated August 4, 1993	Pet. App. A1
Excerpt of 11 U.S.C. § 1129	34

**CHRONOLOGICAL LIST OF
RELEVANT DOCKET ENTRIES**

March 13, 1991 — Respondent Bonner Mall Partnership ("Bonner") files voluntary bankruptcy petition under Chapter 11 in U.S. Bankruptcy Court for the District of Idaho.

April 23, 1991 — Petitioner U.S. Bancorp Mortgage Company ("U.S. Bancorp") files motion for relief from stay in Bankruptcy Court.

August 23, 1991 — Bankruptcy Court issues first Memorandum of Decision.

October 31, 1991 — Bonner files First Amended Plan of Reorganization.

December 6, 1991 — Bankruptcy Court issues second Memorandum of Decision.

July 15, 1992 — District Court issues Opinion and Order.

July 23, 1992 — District Court issues Correction Order.

August 14, 1992 — U.S. Bancorp files Notice of Appeal to the U.S. Court of Appeals for the Ninth Circuit.

August 4, 1993 — Court of Appeals issues Opinion and Order.

**ELSAESSER, JARZABEK, BUCHANAN
& DRESSEL**
P.O. Box 1049
Sandpoint ID 83864
(208) 263-8517

**SHULKIN, HUTTON & BUCKNELL,
INC., P.S.**
1201 Third Avenue, Ste. 1900
Seattle WA 98101
(206) 623-3515
l:pld\ bmp.pla

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO**

In Re:)
BONNER MALL	) Case No. 91-00801
PARTNERSHIP,	) FIRST AMENDED PLAN
	) OF REORGANIZATION
Debtor.)
)
)

Bonner Mall Partnership, an Idaho general partnership, the Debtor in the above-captioned Chapter 11 case, proposes the following Plan of Reorganization pursuant to Subchapter II of Chapter 11 of the Bankruptcy Code:

ARTICLE I - DISCLOSURE STATEMENT

1. The Debtor has filed a Disclosure Statement pursuant to 11 U.S.C. § 1125 and Bankruptcy Rule 3016(c). The Disclosure Statement has been approved by the Bankruptcy Court prior to this Plan being submitted to creditors and equity security holders. The Disclosure Statement provides useful information to aid and assist creditors and equity security

**FIRST AMENDED PLAN
OF REORGANIZATION**

holders in voting on the Plan. YOU ARE URGED TO READ THE DISCLOSURE STATEMENT WITH CARE IN EVALUATING THE IMPACT OF THE PLAN UPON YOUR CLAIMS OR EQUITY SECURITY INTERESTS.

ARTICLE II - DEFINITION OF TERMS

2. A term used in this Plan that is not defined below and that is defined in the Bankruptcy Code shall have the meaning ascribed in the Bankruptcy Code. When used in this Plan, the following terms shall have the meanings specified below, unless the context otherwise requires:

2.1 ALLOWED CLAIM: Any claim in the amount and of the priority classification set forth in the proof of such claim that has been filed timely in the Reorganization Case, or in the absence of such proof, as set forth in the Debtor's schedules of liabilities filed in the Reorganization case, unless: (i) such claim has been listed in such schedules as disputed, contingent, or unliquidated, in which case such claim shall be allowed only in such amount and such classification as is authorized by Final Order of the Bankruptcy Court; (ii) such claim has been objected to or is objected to after Confirmation, in which case such claim shall be allowed only in such amount and such classification as if authorized by Final Order of the Bankruptcy Court; or, (iii) such claim has been paid in full, withdrawn, or otherwise deemed satisfied in full.

2.2 ALLOWED INTEREST: Any Equity Interest in the amount and of the priority classification set forth in the proof of such Equity Interest that has been filed timely in the Reorganization Case, or in the absence of such proof, as set forth in the debtor's listings and schedules filed in the Reorganization Case, unless: (i) such Equity Interest has been objected to or is objected to after confirmation, in which case

such Equity Interest shall be allowed only in such amount and such classification as is authorized by Final Order of the Bankruptcy Court; or (ii) such Equity Interest has been paid in full, withdrawn, or otherwise deemed satisfied in full or retired.

2.3 AS SOON AS PRACTICABLE: Unless extended by court order, within thirty days following the occurrence of a triggering event.

2.4 BANKRUPTCY CODE or CODE: The Bankruptcy Code enacted November 6, 1978, as set forth in Title 11 of the United States Code, and as amended thereafter.

2.5 BANKRUPTCY COURT or COURT: The United States Bankruptcy Court for the District of Idaho, before which the Reorganization Case is pending, or if that Court ceases to exercise jurisdiction over the Bankruptcy Case, the Court that does exercise jurisdiction.

2.6 CLASS: A class of claims or equity security interests as defined in Article III of this Plan.

2.7 CLASS 3 CLAIMS ORDER: The order of the Bankruptcy Court making specific reference to this Plan which fixes and liquidates the amount of all Class 3 claims.

2.8 CONFIRMATION: The entry of the Order of Confirmation by the Bankruptcy Court.

2.9 DEBTOR: Bonner Mall Partnership, an Idaho partnership.

2.10 DISPUTED CLAIM: A filed or scheduled claim of an alleged creditor as to which an objection has been filed by a party in interest.

2.11 EFFECTIVE DATE: The later of January 10, 1992, or eleven days after Confirmation unless the effect of the Order of Confirmation is stayed under Bankruptcy Rule 8005.

2.12 ESTATE: The Estate created pursuant to § 541 of the Bankruptcy Code.

2.13 FINAL ORDER: An order of the Bankruptcy Court confirming the Plan pursuant to Section 1129 of the Bankruptcy Code.

2.15 PETITION DATE: March 13, 1991, the date upon which the Debtor filed the Chapter 11 Petition commencing the Reorganization Case.

2.16 PLAN: This Plan of Reorganization in its present form or as it may be amended or modified from time to time pursuant to order of the Bankruptcy Court.

2.17 PROFESSIONAL PERSONS: Persons retained or to be compensated pursuant to §§ 326, 327, 328, 330 and/or 1103 of the Bankruptcy Code.

2.18 PRO RATA: Proportionately so that the ratio of the amount distributed on account of a particular Allowed Claim to the amount of such Allowed Claim is the same as the ratio of the amount distributed on account of all Allowed Claims in the Class of which such particular Allowed Claim is a member to the total amount of all Allowed Claims in such Class.

2.19 REORGANIZATION CASE: Chapter 11 case pending before the Bankruptcy Court commenced by the Debtor, designated Case No. 91-00801.

2.20 REORGANIZED DEBTOR: As provided by § 1141(d) of the Bankruptcy Code, Bonner Properties, Inc., an Idaho corporation as reconstituted, in accordance with the provisions of this Plan following the Effective Date, with assets that were formerly property of the Estate.

2.21 SECURED CLAIM: An Allowed Claim that is a secured claim against the Debtor determined in accordance with §§ 506 and 552 of the Bankruptcy Code.

2.22 UNCLASSIFIED CLAIM: An Allowed Claim described in § 507(a)(1), (2) or (7) of the Bankruptcy Code and any fees payable pursuant to 28 U.S.C. § 1930.

2.23 UNSECURED CLAIM: An Allowed Claim that is not a Secured Claim.

ARTICLE III - CLASSIFICATION OF CLAIMS AND INTERESTS

3. All claims, as defined in § 101(5) of the Bankruptcy Code, against the Debtor and all equity security interests, as defined in § 101(16) of the Bankruptcy Code, in the Debtor are classified as set forth herein. A claim or interest is in a particular Class only to the extent it qualifies within the definition of such Class and is in a different Class to the extent it qualifies within the definition of such different Class.

3.1 Priority Claims:

3.1.1 Class 1: All Allowed Claims against the Debtor entitled to priority pursuant to § 507(a)(3) of the Bankruptcy Code.

3.2 Secured Claims:

3.2.1 Class 2a: The Secured Claim of U. S. Bank, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.2 Class 2b: The Secured Claim of FNB, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.3 Class 2c: The Secured Claim of Panhandle State Bank, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.4 Class 2d: The Secured Claim of Triangle Development, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.5 Class 2e: The Secured Claim of D. L. Evans Bank, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.3 Unsecured Claims:

3.3.1 Class 3a: All Allowed Claims against the Debtor, however arising, not entitled to priority and not otherwise included in any other Class hereof, including, without limitation, claims based upon the rejection of executory contracts or unexpired leases.

3.3.2 Class 3b: Any Allowed Claims against the Debtor, which total \$1,000 or less and which would otherwise be Class 3a claims and any claims which would otherwise be Class 3a claims but for which the holder elects to be treated as a Class 3b claims holder.

3.3.3 Class 3c: Any Allowed Claims of Lloyd Andrews, H. F. Magnuson and the Debtor's partners which are not Unclassified Claims, which are not entitled to priority and which are not otherwise included in any other Class hereof.

3.4 Equity Interests:

3.4.1 Class 4: The Allowed Interests of all partners of the debtor.

ARTICLE IV

CLAIMS AND INTERESTS NOT IMPAIRED BY THE PLAN

4. The Allowed Claims in Class 1 are not impaired under the Plan.

ARTICLE V.

PROVISIONS FOR SATISFYING CLAIMS
AND SPECIFYING TREATMENT OF
EACH CLASS UNDER THE PLAN

5. The treatment of all Allowed Claims and Allowed Interests are specified as follows:

5.1 Unclassified Claims: Unclassified Claims, upon allowance by the Court will be paid as follows:

5.1.1 Each holder of an Allowed Claim entitled to priority pursuant to § 507(a)(1) of the Code shall receive, from the Reorganized Debtor, as soon as practicable following the later of (a) the Effective Date or (b) the date upon which an order of the Court allowing such claim becomes a Final Order, cash in the amount of such Allowed Claim unless the holder of such Unclassified Claim agrees to different treatment, except for certain ordinary course of business Unclassified Claims, the treatment of which is specified in Paragraph 5.1.2 below; provided that all fees payable pursuant to 28 U.S.C. § 1930 shall be paid prior to or on the Effective Date.

5.1.2 Unclassified Claims incurred by the Debtor during the pendency of the case shall be assumed and paid in the ordinary course of business by the Reorganized Debtor after the Effective Date.

5.1.3 Allowed Claims of governmental units entitled to priority pursuant to § 507(a)(7) of the Code and not otherwise included in any other Class hereof shall be paid by the Reorganized Debtor in twelve (12) equal quarterly cash

payments commencing on the final day of the first full fiscal quarter of the Reorganized Debtor following the later of (a) the Effective Date or (b) the date upon which an order of the Court allowing such claim becomes a Final Order, and amortized with interest over such twelve quarter period. The amortization shall be based on simple interest at a rate equal to seven percent (7%) per annum unless the Court establishes, after notice and a hearing, a different market rate of interest. Any holder of a claim entitled to priority under § 507(a)(7) shall, within the same deadline and in the same manner established for objections to confirmation, file any objection it may have to the proposed interest rate, identify the proposed alternative rate, and set forth the facts and circumstances justifying such rate. Failure to object to the proposed interest rate shall be deemed to be a consent thereto. The holder of an Allowed Claim entitled to priority pursuant to § 507(a)(7) of the Code shall not be entitled to receive any payment on account of any Post-Petition Date penalty or interest with respect to or arising in connection with its claim; and any such claim or demand for Post-Petition Date penalties or interest shall be discharged by Confirmation of this Plan under 1141(d)(1) of the Code, and the holder of such claims shall not assess or attempt to collect such penalty or interest from the Reorganized debtor.

5.2 Priority Claims:

5.2.1 Class 1: Class 1 claims are not impaired under this Plan. Each holder of a Class 1 Allowed Claim shall be paid the entire amount of such holder's Allowed Claim by the Reorganized Debtor on the later of (a) the Effective Date or (b) the date upon which an order of the Court allowing such claim becomes a Final Order.

5.3 Secured Claims:

5.3.1 Class 2a: The holder of the Class 2a claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2a claim otherwise agree to alternative treatment of the claim, the Class 2a Claim shall be satisfied in the manner described in Paragraph 5.3.1.1 below, or if U. S. Bank properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2a claim shall be satisfied in the manner described in Paragraph 5.3.1.2 below.

5.3.1.1. U. S. Bank, the holder of the Secured Claim constituting the Class 2a claim, shall retain its lien securing its Secured Claim and shall receive 31 monthly cash payments in an amount equal to the interest accruing on the Allowed Secured Claim followed by a payment of the full amount of the Allowed Secured Claim on the 32nd monthly anniversary of the Effective Date. The payments shall be made by the Reorganized Debtor and the first payment shall be made on the first monthly anniversary of the Effective Date. For the purposes of this Plan, the Allowed Secured Claim shall be deemed to equal \$3,200,000, the fair market value of the collateral as determined by the Bankruptcy Court on August 23, 1991 plus the amount U.S. Bank has expended on Court authorized roof repairs through confirmation exclusive of funds derived from rent proceeds, offset by any insurance proceeds received. Interest shall be calculated at the lesser of 7% per annum or the rate specified in the contract between the Debtor and U. S. Bank, or at the rate set by the Bankruptcy Court at confirmation.

On the effective date of the Plan, the Debtor shall deposit in an escrow account a Deed in Lieu of Foreclosure in favor of U. S. Bank to the Bonner Mall. In the event Bonner Properties, Inc. fails to make the monthly cash payments to

U. S. Bank, fails to pay the property taxes and insurance on the Bonner Mall as they become due, fails to complete the repairs to the mall roof on or before October 15, 1992, or fails to pay the full amount of the Allowed Secured Claim on the 32nd monthly anniversary of the Effective Date, Debtor shall, upon appropriate motion and hearing by U. S. Bank, deliver the deed to the Bank. The Deed in Lieu of Foreclosure shall be the equivalent of a non-judicial foreclosure and in the event U.S. Bank exercises its right to the Deed, it will have foregone any right to seek a deficiency judgment pursuant to State Mortgage Foreclosure Law.

5.3.1.2 If the holder of the Class 2a claim is entitled to and does timely make an election under §1111(b) of the Bankruptcy Code, U.S. Bank shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the Reorganized Debtor in equal monthly installments over a period of time, not less than thirty (30) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payment shall commence on the Effective Date.

5.3.1.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of U. S. Bank.

5.3.2 Class 2b: The holder of the Class 2b claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2b claim otherwise agree to alternative treatment of the claim, the Class 2b claim shall be satisfied in the manner described in Paragraph 5.3.2.1 below, or if First National Bank of North Idaho (FNB) properly elects application of § 1111(b) of the Bankruptcy Code, then the

Class 2b claim shall be satisfied in the manner described in Paragraph 5.3.2.2 below.

5.3.2.1 FNB, the holder of the Secured Claim constituting the Class 2b claim, shall retain its lien securing its Secured Claim and shall receive a payment of the full amount of the Allowed Secured Claim plus the interest accruing on such Allowed Secured Claim from the Effective Date on the 32nd monthly anniversary of the Effective Date. The payment shall be made by the Reorganized Debtor. For the purposes of this Plan, the Allowed Secured Claim shall be deemed to equal \$400,000, the fair market value of the collateral. Interest shall be calculated at the lesser of 7% per annum or the rate specified in the contract between the Debtor and FNB, or at the rate set by the Bankruptcy Court at confirmation.

5.3.2.2 If the holder of the Class 2b claim is entitled to and does timely make an election under § 1111(b) of the Bankruptcy Code, then FNB shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the Reorganized Debtor in equal monthly installments over a period of time, not less than thirty (30) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payment shall commence on the Effective Date.

5.3.2.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of FNB.

5.3.3 Class 2c: The holder of the Class 2c claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2c claim otherwise agree to alternative

treatment of the claim, the Class 2c claim shall be satisfied in the manner described in Paragraph 5.3.3.1 below, or if Panhandle State Bank (PSB) properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2c claim shall be satisfied in the manner described in Paragraph 5.3.3.2 below.

5.3.3.1 PSB, the holder of the Secured Claim constituting the Class 2c claim, shall retain its lien securing its Secured Claim and shall receive monthly cash payments of \$800 until the Class 2c claim is paid. The payments shall be made by the Reorganized Debtor and the first payment shall be made on the first monthly anniversary of the Effective Date. For the purposes of this plan, the Allowed Secured Claim shall be deemed to equal \$40,000, the fair market value of the collateral on the Petition Date minus all payments made to PSB after the Petition date. Interest shall be calculated at the lesser of 7% per annum or the rate specified in the contract between the Debtor and PSB, or at the rate set by the Bankruptcy Court at confirmation.

5.3.3.2 If the holder of the Class 2c claim is entitled to and does timely make an election under § 1111(b) of the Bankruptcy Code, PSB shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the Reorganized Debtor in equal monthly installments over a period of time, not less than ten (10) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payment shall commence on the Effective Date.

5.3.3.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of PSB.

5.3.4 Class 2d: The holder of the Class 2d claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2d claim otherwise agree to alternative treatment of the claim, the Class 2d claim shall be satisfied in the manner described in Paragraph 5.3.4.1 below, or if Triangle Development Company (Triangle) properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2d claim shall be satisfied in the manner described in Paragraph 5.3.4.2 below.

5.3.4.1 Triangle, the holder of the Secured Claim constituting the Class 2d claim, shall retain its lien securing its Secured Claim and shall receive four annual cash payments in an amount equal to the interest accruing on the Allowed Secured Claim followed by a payment of the full amount of the Allowed Secured Claim on the fifth anniversary of the Petition Date. The payments shall be made by the Reorganized Debtor and the first payment shall be made on the first anniversary of the Petition Date. For the purposes of this Plan, the Allowed Secured Claim shall be deemed to equal the principal amount of the claim on the Petition Date plus the interest accrued through the Petition Date, which is less than the fair market value of the collateral. Interest shall be calculated at the lesser of 7% per annum or the rate specified in the contract between the Debtor and Triangle, or at the rate set by the Bankruptcy Court at confirmation.

5.3.4.2 If the holder of the Class 2d claim is entitled to and does timely make an election under § 1111(b) of the Bankruptcy Code, then Triangle shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the

Reorganized Debtor in equal monthly installments over a period of time, not less than thirty (30) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payments shall commence on the Effective Date.

5.3.4.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of Triangle.

5.3.5 Class 2e: The holder of the Class 2e claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2e claim otherwise agree to alternative treatment of the claim, the Class 2e claim shall be satisfied in the manner described in Paragraph 5.3.5.1 below, or if D. L. Evans Bank properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2e claim shall be satisfied in the manner described in Paragraph 5.3.5.2 below.

5.3.5.1 D. L. Evans Bank, the holder of the Secured Claim constituting the Class 2e claim, shall retain its lien securing its Secured Claim and shall receive monthly cash payments in an amount equal to \$2,775 until its Allowed Secured Claim together with interest accruing following the Effective Date is paid. The payments shall be made by the Reorganized Debtor and the first payment shall be made on the first monthly anniversary of the Effective Date. For the purposes of this Plan, the Allowed Secured Claim shall be deemed to equal the outstanding principal balance of the claim as of the Effective Date after giving effect to the post Petition Date payments, which is less than the fair market value of the collateral. Interest shall be calculated at the lesser of 7% per annum or the rate specified in the contract between the Debtor

and D. L. Evans Bank, or at the rate set by the Bankruptcy Court at confirmation.

5.3.5.2 If the holder of the Class 2e claim is entitled to and does timely make an election under § 1111(b) of the Bankruptcy Code, then D. L. Evans Bank shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the Reorganized Debtor in equal monthly installments over a period of time, not less than thirty (30) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payment shall commence on the Effective Date.

5.3.5.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of D. L. Evans Bank.

5.4 Unsecured Claims:

5.4.1 Class 3a: Class 3a claims are impaired under this Plan. In full and complete satisfaction of Class 3a claims, holders of Allowed Claims in Class 3a shall receive, As Soon As Practicable following the date the Class 3 Claims Order becomes a Final Order, a Pro Rata distribution of Class A Preferred Stock issued by the Reorganized Debtor pursuant to the provisions of Paragraph 7.3 of the Plan. Fractional shares shall not be issued.

5.4.2 Class 3b: Class 3b claims are impaired under this Plan. In full and complete satisfaction of Class 3b claims, holders of Allowed Claims in Class 3b shall receive a cash payment equal to the lesser of 10% of the allowed amount of their claims or \$100. The payment shall be made by the

Reorganized Debtor As Soon As Practicable following the date an order of the court allowing any class 3b claim becomes a Final Order.

5.4.3 Class 3c: Class 3c claims are fully impaired under this Plan. Class 3c claims shall receive no stock distribution or cash payment.

5.5 Equity Security Interests.

5.5.1 Class 4: The holders of Class 4 interests shall retain no interest in the Debtor and any interests held by such holders shall be canceled on the Effective Date.

ARTICLE VI.

TREATMENT OF DISPUTED CLAIMS AND INTERESTS

6. Except as provided in Paragraph 5.4.2 above, all Disputed Claims will be resolved prior to any distributions by the Reorganized Debtor. Equity Security Interests are not entitled to any distributions from the Reorganized Debtor under this Plan.

ARTICLE VII.

MEANS FOR EXECUTION OF THE PLAN

7. The Debtor, the Estate, and Reorganized Debtor shall each perform or shall have performed all the acts required of them below, (unless the Debtor, the Estate, and the Reorganized Debtor all shall agree to perform such acts at an earlier time) on the Effective Date of the Plan.

7.1 All assets of the Estate shall be vested in the Reorganized Debtor in accordance with 11 U.S.C. § 1141 and the Reorganized Debtor shall be free to manage its affairs with no further Court intervention, including the lawful manner of selecting directors and officers.

7.2 The existing partners, the five trusts, and Lloyd Andrews shall make a capital contribution to the Reorganized Debtor in an amount equal to \$200,000. In the event of a shortfall in working capital, for the 32 month period between the Effective Date of the Plan and the date the note to U.S Bank comes due, the new shareholders will contribute any funds necessary to make the monthly payments under the Plan and to pay the reasonable and ordinary operating expenses of the Mall. In consideration of the required capital contribution, the Reorganized Debtor shall issue two million of the four million authorized shares of common stock, in accordance with the terms of this Plan and the Amended Articles of Incorporation required hereby, to the former partners. The common stock and the Class A preferred stock to be issued by the Reorganized Debtor to the holders of Class 3a unsecured claims are the only securities authorized by this Plan and no other equity securities are authorized or are to be issued by the Reorganized Debtor pending final consummation of this Plan.

7.3 Three hundred thousand Class A preferred shares shall be issued by the Reorganized Debtor to the holders of Class 3a unsecured claims. The Class A preferred stock shall have a par value of \$1.00 per share, shall be convertible, at any time after the final payment of the Class 2a secured claim and prior to redemption, into fifteen percent (15%) of the then outstanding common stock of the Reorganized Debtor, shall have a preference equal to the par value upon the liquidation of the Reorganized Debtor, and shall be redeemable

at par, at the option of the Reorganized Debtor, and shall be entitled to vote, on the same basis as the common shares.

7.4 U.S. Bank shall transfer all funds it holds as collections from the rents of the property to the Reorganized Debtor.

7.5 H. F. Magnuson shall provide a collateral trust mortgage to the Reorganized Debtor which shall act as additional collateral for any creditor to insure that the entire indebtedness assumed by the Reorganized Debtor in conjunction with this Plan is paid in accordance with the terms of the Plan. The collateral trust Mortgage shall encumber approximately 4,500 acres of real property located generally on the Rathdrum Prairie. The collateral trust mortgage shall be junior to existing liens on the Rathdrum property which secure approximately \$2,500,000. H. F. Magnuson shall continue to service \$1,500,000 of the indebtedness encumbering the property and in partial exchange for providing the collateral trust mortgage, the Reorganized Debtor shall pay the debt service on approximately \$902,000 of the debt encumbering the property.

7.6 On the Effective Date of the Plan, the Reorganized Debtor and Bonner Properties, Inc. shall assume responsibility for completing the \$300,000.00 in court authorized repairs to the mall roof begun by U.S. Bank. Said work shall be performed under the direct supervision of architect, Ferman Pasold, and with consultation from U.S. Bank. The remaining work will be contracted for completion on or before October 15, 1992.

7.7 Notwithstanding any provision to the contrary in this Plan, all rights, claims, and causes of action, whether equitable or legal, of the Debtor, the Estate, or the

Reorganized Debtor against all persons arising under any provision of the Bankruptcy Code, under state or federal law for the recovery of avoidable fraudulent conveyances or other transfers or under any other State or Federal law, shall be vested in the Reorganized Debtor. During the pendency of the Reorganization Case, prior to or following Confirmation, the Debtor-in-Possession or the Reorganized Debtor may commence adversary proceedings against persons or entities to realize upon any such causes of action. Any settlements shall be subject to review by the Bankruptcy Court, after appropriate notice and hearing in accordance with the Bankruptcy Rules.

7.8 The Reorganized Debtor shall cause Amended Articles of Incorporation, in the form approved by the Court at the hearing on confirmation, to be filed in accordance with state law.

7.9 Any objection to a claim by a party in interest in the Reorganization Case must be filed on or before one hundred twenty (120) days following the Effective Date unless said time period is extended by the Bankruptcy Court for cause shown; provided, however, that the foregoing limitation does not apply to any claims filed subsequent to Confirmation.

7.10 Pursuant to Section 347(b) of the Bankruptcy Code, ninety (90) days after any distribution by the Reorganized Debtor provided for herein, the Reorganized Debtor shall stop payment on any check remaining unpaid or cancel any stock issued to a holder of an Allowed Claim and any funds or canceled shares shall be returned to the Reorganized Debtor. From and after the date the Reorganized Debtor stops payment on any distribution check or cancels shares pursuant to paragraph 7.9, the holder of the claim on account of which such check or shares were issued shall be entitled to receive no further distributions on account of his

claim and such holder's Allowed Claim shall thereupon be deemed satisfied in full.

7.11 The deadline for submission of all claims entitled to priority pursuant to Sections 507(a)(1), (a)(2) and (b) of the Bankruptcy Code incurred prior to Confirmation, with the exception of fees and costs of Professional Persons shall be thirty (30) days following Confirmation. Failure to file a claim by this date shall conclusively bar the claimant from asserting his claim, which claim shall be forever discharged.

7.12 Any negotiable instrument held by the holder of an impaired Allowed Claim shall be deemed exchanged, canceled, or satisfied, as the case may be on the Effective Date.

7.13 The Reorganized Debtor shall timely make all payments required under this Plan.

ARTICLE VIII EXECUTORY CONTRACTS AND UNEXPIRED LEASES

8 The treatment of executory contracts and unexpired leases is specified below.

8.1 All executory contracts and unexpired leases of the Debtor not heretofore assumed or rejected, shall be assumed by the Debtor on the Effective Date, except those executory contracts and unexpired leases listed in the "Schedule of Rejected Executory Contracts" which is attached hereto as Exhibit A. Any claim arising from the rejection of an executory contract is a Class 3a claim and, any entity holding a claim based upon the rejection of an executory contract or unexpired lease pursuant to this Article must file a Proof of Claim with the Bankruptcy Court within 30 days after

Confirmation. The failure of any such entity to file a Proof of Claim within the specified time period will result in the disallowance of such claim.

8.2 With regard to those executory contracts and unexpired leases which are not listed on Exhibit A, on the Effective Date, or as soon thereafter as is practicable, the Reorganized Debtor shall (a) cure the arrearages, if any, in such amounts as may be determined by the Court at the hearing on Confirmation or thereafter and (b) assume said executory contracts. Any party to an executory contract or unexpired lease scheduled for assumption as provided in this paragraph 8.2 shall, within the same deadline and in the same manner established for objections to confirmation, file any claim for arrearages required to be cured by Section 365(b)(1) of the Bankruptcy Code and any objections to the assumption. Failure to assert such arrearages or to file any objections shall constitute an agreement to the assumption and an acknowledgment that no defaults or claims exist under said contract which require a cure.

ARTICLE IX SATISFACTION OF INDEBTEDNESS AND DISCHARGE OF CLAIMS

9 The distribution made to the various Classes of creditors as provided for in this Plan shall be in full and complete satisfaction of their Allowed Claims. Except as otherwise provided in the Plan or the Order of Confirmation, Confirmation shall operate, as a discharge of any and all debts and claims as defined in Section 101(4) of the Bankruptcy Code against the Debtor or the Estate that arose at any time prior to Confirmation. The discharge of the Debtor and the discharge of claims against the Debtor, whether asserted against the Debtor or the Reorganized Debtor, shall be

effective as to each claim, regardless of whether or not (a) the claim was scheduled, (b) a proof of claim was filed, (c) the claim is an Allowed Claim, or (d) the holder thereof voted to accept the Plan.

ARTICLE X MODIFICATIONS OF THE PLAN

10 Pursuant to the provisions of Section 1127 of the Bankruptcy Code and Bankruptcy Rule 3019, the Debtor reserves the right to modify or alter the provisions of the Plan at any time prior or subsequent to Confirmation.

ARTICLE XI CORPORATE STRUCTURE

11 Pursuant to the requirements of Section 1123(a)(6) of the Bankruptcy Code, upon Confirmation, the Debtor will seek an order of the Court approving the Reorganized Debtor's Amended Articles of Incorporation, which Articles will set forth the rights and privileges of the holders of common stock and which will include, among other matters, a prohibition on the Reorganized Debtor's issuance of non-voting securities and as to additional authorized classes of securities, if any, an appropriate distribution of voting power, including, in the case of any class having a preference over another class with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in payment of such dividends.

ARTICLE XII
RETENTION OF JURISDICTION
BY THE BANKRUPTCY COURT

12 Notwithstanding Confirmation, until entry of a final decree, the Bankruptcy Court shall retain jurisdiction to ensure that the purposes and intent of the Plan are carried out. Without limiting the generality of the foregoing, the Court shall retain jurisdiction for the following purposes:

12.1 Fixing and allowing any claim as a cost and expense of the administration of the Reorganization Case;

12.2 Reexamining any claim that has been allowed;

12.3 Hearing and determining any objection to a claim or interest. The failure of the Debtor to object to, or to examine any claim or equity security interest for the purpose of voting, shall not be deemed to be a waiver of the Debtor's right to object to, or re-examine any claim or equity security interest in whole or in part;

12.4 Hearing and determining any action brought by the Debtor or the Estate seeking to avoid any transfer of an interest of the Debtor in property, or any obligation incurred by Debtor, that is avoidable pursuant to applicable law;

12.5 Hearing and determining all causes of action, controversies, disputes, or conflicts between or among the Debtor and any other party, including those that were pending prior to Confirmation;

12.6 Hearing and determining all questions and disputes regarding title to the property of the Debtor or the Estate;

12.7 Correcting any defect, curing any omission, or reconciling any inconsistency in the Plan or the Order of Confirmation as may be necessary to carry out the purpose and intent of the Plan;

12.8 Hearing and determining any action brought by the Debtor to protect the Debtor and the Estate from actions of creditors, equity security holders, or other parties in interest;

12.9 Issuing any order necessary to implement the Plan or Order of Confirmation, including, without limitation, such declaratory and injunctive orders as are appropriate to protect the Debtor, the Estate, and the Reorganized Debtor from actions of creditors, equity security holders, or other parties in interest;

12.10 Hearing and determining any dispute relating to the terms or implementation of the Plan or Order of Confirmation, or to the rights or obligations of any parties in interest with respect thereto;

12.11 The modification of the Plan after Confirmation pursuant to the Bankruptcy Rules and the Bankruptcy Code in accordance with Article X above; and

12.12 Entering orders concluding and terminating the Reorganization Case.

DATED this 29 day of October, 1991.

SHULKIN, HUTTON & BUCKNELL,
INC., P.S.

ELSAESSER, JARZABEK, BUCHANAN
& DRESSEL

/s/ Barbara Buchanan
BARBARA BUCHANAN, Attorneys for
Debtor-in-Possession

EXHIBIT "A"

SCHEDULE OF REJECTED EXECUTORY CONTRACTS
AND UNEXPIRED LEASES

Non-Debtor Party

Nature of Agreement

FIRST AMENDED PLAN
OF REORGANIZATION

FIRST AMENDED PLAN
OF REORGANIZATION

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO

In Re:
 BONNER MALL
PARTNERSHIP,
Debtor.)
) Case No. 91-00801-11
) MEMORANDUM
) OF DECISION
)

J. Ford Elsaesser and Barbara A. Buchanan, ELSAESER,
JARZABEK & BUCHANAN, Sandpoint, Idaho, for debtors.

Dale G. Higer, STOEL, RIVES, BOLEY, JONES & GREY,
Boise, Idaho, for U.S. Bancorp.

U.S. Bancorp Mortgage Company (Bancorp) has renewed its motion for relief from the Section 362 automatic stay or for dismissal of the chapter 11 case filed by the debtor-in-possession, the Bonner Mall Partnership. The motions were previously denied; the debtor was ordered to file a plan, and Bancorp authorized to renew its motions to test the confirmability of the debtor's proposed chapter 11 plan. The present motions constitute such renewal.

The issue is whether the debtor's proposed plan bears any possibility of success of confirmation under the provisions of 11 U.S.C. § 1129.

Findings and conclusions in the previous motions process included the conclusion Bancorp was not entitled to relief from the Section 362 automatic stay under 11 U.S.C. § 362(d)(2). In the instant, renewed, motions, the same conclusion will be entered. While the debtor-in-possession may possess no equity in the Bonner Mall, it obviously is necessary for an effective reorganization, and no cause has been shown to exist for a modification, or total relief, from the

automatic stay under 11 U.S.C. § 362(d)(1), other than the issue of the inability of the debtor to obtain confirmation of the chapter 11 plan.

Both the issues of the motion to dismiss and the motion for stay relief must be resolved solely on the basis of the confirmability of the debtor's proposed plan. Any benefit of the doubt in this regard ought to be afforded the debtor, and only if there is no chance of confirmation under the provisions of Section 1129 should the motions be granted.

THE PLAN

The proposed plan of reorganization provides for the transfer of all of the assets of the debtor-in-possession to a corporation. The new corporation will be the reorganized debtor, or, the entity created by the chapter 11 plan to carry out the reorganization process through the performance of the plan provisions. All unsecured creditors, with the exception of the Magnuson Children's Trusts, will receive shares in a class of preferred stock in the reorganized debtor corporation. After the payment of the secured claim of Bancorp in the amount of \$3.2 million, the preferred stock will be converted into 15% of the then outstanding shares of common stock in the reorganized debtor corporation. The preferred stock is also given a liquidation preference ahead of the common stock on the basis of its \$1.00 per share par value. The existing equity holders in the partnership comprising the debtor-in-possession will make a capital contribution of \$200,000.00, and H.F. Magnuson will assign to the reorganized debtor a collateral trust mortgage in which there purportedly exists an equity of \$2 million.

DISCUSSION

Previous findings of the value of the Bonner Mall, of \$3.2 million, the amount of the claim of Bancorp, and the provisions of 11 U.S.C. § 1129, including Section

1129(b)(2)(B), led to the opinion announced in the previous motions process that it would be extremely difficult for the debtor to obtain confirmation of a chapter 11 plan. Since Bancorp controls the class of unsecured creditors, the debtor cannot obtain confirmation of a plan under Section 1129(a) and thus must resort to the provisions of Section 1129(b). The main impediment to confirmation, under Section 1129(b), is the absolute priority rule¹, with which provisions the debtor must comply in order to meet the "fair and equitable" test of that section.

Bancorp contends the debtor's proposed plan cannot satisfy the "fair and equitable" requirement since the plan does not comply with the absolute priority rule. Bancorp argues the absolute priority rule is violated since the Bank will not be receiving payment of its unsecured claim in full, while the debtor is retaining an interest in the property.

In response, the debtor-in-possession argues the absolute priority rule is satisfied by the "new contribution" feature of its plan, whereby new capital is being contributed to the plan by existing equity shareholders of the debtor, which additional capital is "reasonably equivalent" to the value of the property interests the debtor is retaining through the plan.

Bancorp argues the "new contribution" theory, which resulted from a United States Supreme decision² is not a viable concept under the 1978 Bankruptcy Code³ and should not be available to the debtor-in-possession.

¹ 11 U.S.C. § 1129(b)(2)(B)(ii).

² *Case v. City of Los Angeles Lumber*, 308 U.S. 106 (1939).

³ Pub.L. 95-598, Nov. 6, 1978.

Since the time of the previous decision on this subject in this case, the Fifth Circuit Court of Appeals in *Phoenix Mutual Life Ins. Co. v. Greystone III Joint Venture*⁴ has held the new value exception is not available under the Bankruptcy Code.⁵ The opinion holds the 1978 Bankruptcy Code did not provide for new value exception to the absolute priority rule. The Court discussed the effect of allowing the exception under the present Code and found that to do so would allow "old equity" to retain control of, and run, the reorganized debtor while impairing the rights of dissenting secured creditors and that such treatment is not authorized and should not be authorized under the present statutes.

The *Greystone* analysis is convincing, as is the reasoning to like effect in *In re Outlook/Century, Ltd.*.⁶ As in *Greystone*, to allow the debtor equity holders in this case to retain controlling interest in the new entity while reducing the

⁴ No. 90-8529, 1991 U.S. App. LEXIS 27096 (5th Cir. Nov. 19, 1991).

⁵ *Greystone* states the status of the decision on this subject in footnote 8: "*In Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 967 n.3 (1988), the Supreme Court expressly declined to rule on whether a "new value exception" to the absolute priority rule survived enactment of the Bankruptcy Code. The circuit courts are divided. See, e.g. *Kham & Nate's Shoes No. 2 v. First Bank*, 908 F.2d 1351 (7th Cir. 1990) (dicta) (questioning continued vitality of absolute priority rule); *In re Anderson*, 913 F.2d 530, 532-33 (8th Cir. 1990) (exception exists); *In re U.S. Truck Co.*, 800 F.2d 581, 587-88 (6th Cir. 1986). Bankruptcy courts have been sharply divided on the issue. Compare *In re Outlook/Century, Ltd.*, 127 B.R. 650, 656 (Bankr. N.D. Cal. 1991) and *In re Lumber Exchange Ltd. Partnership*, 125 Bankr. 1000 (Bankr. Minn. 1991) (no new value exception), with *In re Sawmill Hydraulics, Inc.*, 72 B.R. 454, 456 n.1 (Bankr. C.D. Ill. 1987).

⁶ 127 B.R. 650 (Bankr. N.D. Cal. 1991).

amount of the Bancorp secured claim and not paying the unsecured claim in full would violate the absolute priority rule.

In effect, on the basis of these findings and conclusions, Bancorp is entitled to relief on both of its motions. The motion for stay relief ought to be granted for cause under Section 362(d)(1) since the debtor's proposed plan is not capable of being confirmed, and the motion to dismiss is appropriate for the same reason under the provisions of Section 1112(2). Although it is difficult to perceive of any necessity to keep the case open since the Bonner Mall is the main purpose of the attempted reorganization, some purely practical reason may exist. Therefore, Bancorp's motion for stay relief will be granted, and the motion to dismiss will be denied at this time.

A separate order will be entered.

Dated this 6th day of December, 1991.

/s/Alfred C. Hagan
ALFRED C. HAGAN
U.S. BANKRUPTCY JUDGE

ACH:jbc

EXCERPT OF 11 U.S.C. § 1129

§ 1129. Confirmation of plan.

(a) The court shall confirm a plan only if all of the following requirements are met:

...
(8) With respect to each class of claims or interests—

- (A) such class has accepted the plan; or
- (B) such class is not impaired under the plan.

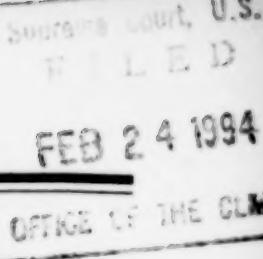
...
(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

...
(B) With respect to a class of unsecured claims—

- (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.



IN THE
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,

v.
BONNER MALL PARTNERSHIP,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF PETITIONER

Bradford Anderson*

Dale G. Higer

David B. Levant

**Counsel of Record*

STOEL RIVES BOLEY JONES
& GREY

3600 One Union Square

600 University Street

Seattle, WA 98101-3197

(206) 624-0900

Counsel for Petitioner

67 pp

QUESTION PRESENTED

Whether the new value exception to the absolute priority rule survived enactment of the Bankruptcy Reform Act of 1978, permitting the debtor in a Chapter 11 bankruptcy case to confirm a nonconsensual plan of reorganization that allows the debtor's equity holders to retain ownership of the reorganized debtor while paying objecting creditors less than the full amount of their claims.

LIST OF PARTIES

The petitioner is U.S. Bancorp Mortgage Company. The parent corporation of U.S. Bancorp Mortgage Company is U.S. Bancorp. U.S. Bancorp is also the parent corporation of U.S. Bank of Oregon, U.S. Bank of Washington, and U.S. Bank of California. U.S. Bancorp Mortgage Company has no subsidiaries.

Respondent is Bonner Mall Partnership.

TABLE OF CONTENTS

	<u>Page</u>
OPINIONS BELOW	1
JURISDICTION	2
STATUTORY PROVISION INVOLVED	2
STATEMENT OF THE CASE	4
SUMMARY OF THE ARGUMENT	9
 ARGUMENT:	
THE BANKRUPTCY CODE DOES NOT PERMIT A NEW VALUE EXCEPTION	12
I. Any Pre-Code Practice Recognizing the New Value Exception Is Irrelevant Unless the Plain Meaning of Section 1129(b)(2)(B)(ii) Can Be Intrinsically or Extrinsically Impeached	13
II. The Meaning of Section 1129(b)(2)(B)(ii) Is Plain and Does Not Allow Any Exceptions To the Absolute Priority Rule	21
A. The Meaning of Section 1129(b)(2)(B)(ii) is Plain and Unambiguous	21

B.	The Court of Appeals Rejected the Plain Meaning of Section 1129(b)(2)(B)(ii) Based on an Obvious Error	23
C.	The Court of Appeals' Interpretation of Section 1129(b)(2)(B)(ii) Is Untenable	25
D.	The Ninth Circuit's Alternative Interpretation of Section 1129(b)(2)(B)(ii) Does Not Render the Section Ambiguous	27
E.	The New Value Exception Is Not a Corollary to Section 1129(b)(2)(B)(ii)	28
III.	The Plain Meaning of Section 1129(b)(2)(B)(ii) Is Confirmed By Its Legislative History and Cannot Be Extrinsically Impeached	29
A.	The Plain Meaning of Section 1129(b)(2)(B)(ii) is Supported by the Legislative History of the Code	30
B.	The Plain Meaning of Section 1129(b)(2)(B)(ii) Is Not Contrary to Bankruptcy or Nonbankruptcy Policy	34
IV.	The Bankruptcy Code Changed the Confirmation Process So Fundamentally That Pre-Code Practice Should Be Disregarded	40
A.	The Bankruptcy Code Defines What Is "Fair and Equitable"	43

B.	The Bankruptcy Code Liberalized the Confirmation Process, Obviating the Need for a New Value Exception	44
C.	The Code Enlarged the Powers of Debtors' Management and Owners	46
D.	The New Value Exception would Skew the Code's Balance between Debtors and Creditors by Injecting the Courts into Disputes that Congress Left to the Parties	47
	CONCLUSION	49

TABLE OF AUTHORITIES

Cases	Page
<i>Anderson v. Farm Credit Bank of St. Paul (In re Anderson)</i> , 913 F.2d 530 (8th Cir. 1990) . . .	23, 39
<i>In re A.V.B.I., Inc.</i> , 143 B.R. 738 (Bankr. C.D. Cal. 1992)	12, 35, 41, 43, 45, 46, 47
<i>In re Bjolmes Realty Trust</i> , 134 B.R. 1000 (Bankr. D. Mass 1991)	38
<i>Case v. Los Angeles Lumber Prods. Co.</i> , 308 U.S. 106 (1939)	<i>passim</i>
<i>Chisom v. Roemer</i> , 111 S. Ct. 2354 (1991)	27
<i>Connecticut Nat'l Bank v. Germain</i> , 112 S. Ct. 1146 (1992)	28
<i>Dewsnup v. Timm</i> , 112 S. Ct. 773 (1992)	<i>passim</i>
<i>In re Drimmel</i> , 108 B.R. 284 (Bankr. D. Kan. 1989) . .	27
<i>Harrison v. PPG Indus., Inc.</i> , 446 U.S. 578 (1980) . . .	17
<i>Kansas City Terminal Ry. Co. v. Central Union Trust Co.</i> , 271 U.S. 445 (1926)	43
<i>Kelly v. Robinson</i> , 479 U.S. 36 (1986)	14, 15
<i>Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting</i> , 908 F.2d 1351	12, 43, 45, 48

Cases (continued)	Page
<i>Long v. Bullard</i> , 117 U.S. 617 (1886)	40
<i>Lumber Exch. Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exch. Ltd. Partnership)</i> , 125 B.R. 1000 (Bankr. D. Minn. 1991)	12, 44, 45
<i>Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.</i> , 317 U.S. 78 (1942)	46
<i>Mason v. Paradise Irrigation Dist.</i> , 326 U.S. 536 (1946)	46
<i>Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection</i> , 474 U.S. 494 (1986)	10, 13, 14
<i>In re Montgomery Court Apartments, Ltd.</i> , 141 B.R. 324 (Bankr. S.D. Ohio 1992)	38
<i>NLRB v. Bildisco & Bildisco</i> , 465 U.S. 513 (1984)	34, 35
<i>Nobelman v. American Sav. Bank</i> , 113 S. Ct. 2106 (1993)	24
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988)	<i>passim</i>
<i>Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)</i> , 781 F.2d 99 (7th Cir. 1986)	23
<i>In re Outlook/Century Ltd.</i> , 127 B.R. 650 (Bankr. N.D. Cal. 1991)	8, 30, 43, 46

Cases (continued)	Page
<i>Patterson v. Shumate</i> , 112 S. Ct. 2242 (1992)	10, 28
<i>Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership</i> (<i>In re Woodscape Ltd. Partnership</i>), 134 B.R. 165 (Bankr. D. Md. 1991)	38
<i>Pennsylvania Dept. of Public Welfare v. Davenport</i> , 495 U.S. 552 (1990)	13, 16, 18
<i>Pepper v. Litton</i> , 300 U.S. 295 (1937)	35
<i>Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture</i> (<i>In re Greystone III Joint Venture</i>), 948 F.2d 134, 995 F.2d 1274 (5th Cir. 1992)	8, 12, 38
<i>Piedmont Assocs. v. CIGNA Property & Casualty Ins. Co.</i> , 132 B.R. 75 (N.D. Ga. 1991)	27
<i>Prudential Ins. Co. v. F.A.B. Indus.</i> (<i>In re F.A.B. Indus.</i>), 147 B.R. 763 (C.D. Cal. 1992)	38
<i>Rake v. Wade</i> , 113 S. Ct. 2187 (1993)	28
<i>Regents of the Univ. of Cal. v. Public Employment Relations Bd.</i> , 485 U.S. 589 (1988)	26
<i>In re SLC Ltd. V</i> , 137 B.R. 847 (Bankr. D. Utah 1992)	21, 38
<i>Smith v. United States</i> , 113 Ct. 2050 (1993)	22
<i>Snyder v. Farm Credit Bank of St. Louis</i> (<i>In re Snyder</i>), 967 F.2d 1126 (7th Cir. 1992)	21, 38

Cases (continued)	Page
<i>In re Sovereign Group 1985-27, Ltd.</i> , 142 B.R. 702 (E.D. Pa. 1992)	21
<i>TVA v. Hill</i> , 437 U.S. 153 (1978)	29
<i>Travelers Ins. Co. v. Bryson Properties, XVIII</i> (<i>In re Bryson Properties, XVIII</i>), 961 F.2d 496 (4th Cir. 1992)	38
<i>Union Bank v. Wolas</i> , 112 S. Ct. 527 (1991)	12, 18, 41, 42
<i>United States v. Monia</i> , 317 U.S. 424 (1943)	22
<i>United States v. Ron Pair Enters., Inc.</i> , 489 U.S. 235 (1989)	<i>passim</i>
<i>United States v. Whiting Pools, Inc.</i> , 462 U.S. 198 (1983)	34
<i>In re Winters</i> , 99 B.R. 658 (Bankr. W.D. Pa. 1989) . .	43
Statutes	
11 U.S.C. § 96 (repealed)	41
11 U.S.C. § 101	2
11 U.S.C. § 101(5)	21
11 U.S.C. § 101(16)	22
11 U.S.C. § 362(a), (d)	5

Statutes (continued)	Page
11 U.S.C. § 363	27
11 U.S.C. § 501(a)	22
11 U.S.C. § 506(a), (d)	19, 20
11 U.S.C. § 506(b)	15
11 U.S.C. § 523(a)(7)	14
11 U.S.C. § 541(c)(2)	28
11 U.S.C. § 547(b), (c)	41
11 U.S.C. § 554(a)	14
11 U.S.C. § 1101	5
11 U.S.C. § 1107	5
11 U.S.C. § 1111(b)	5
11 U.S.C. § 1123(a)(5)(D)	27
11 U.S.C. § 1129(a)(11)	27
11 U.S.C. § 1129(b) <i>passim</i>	
18 U.S.C. § 1696(c)	26
28 U.S.C. § 158(d)	8
28 U.S.C. § 1254(1)	2
42 U.S.C. § 7607(b)(1)	17

Legislative Materials	Page
124 Cong. Rec. H11,105 (daily ed. ept. 28, 1978)	11, 31
124 Cong. Rec. S17,421 (daily ed. Oct. 6, 1978)	31
H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 357 (1977)	20, 31, 34
S. Rep. No. 95-989, 95th Cong., 2d Sess. 127 (1978)	33
S. Rep. No. 95-1106, 95th Cong., 2d Sess. (1978)	32
Other Authorities	
John D. Ayer, <i>Rethinking Absolute Priority After Ahlers</i> , 87 Mich. L. Rev. 963 (1989)	37
Douglas G. Baird & Thomas H. Jackson, <i>Bargaining After the Fall and the Contours of the Absolute Priority Rule</i> , 55 U. Chi. L. Rev. 738 (1988)	36, 37
Collier on Bankruptcy (Lawrence P. King ed., 15th ed. 1993)	23, 38
Felix Frankfurter, <i>Some Reflections on the Reading of Statutes</i> , 47 Colum. L. Rev. 527 (1947)	9, 21
Kenneth N. Klee, <i>Cram Down II</i> , 64 Am. Bankr. L.J. 229 (1990)	30, 37

Other Authorities (continued)	Page
Raymond T. Nimmer, <i>Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions</i> , 36 Emory L.J. 1009, 1052 (1987)	36, 37, 38
Elizabeth Warren, <i>A Theory of Absolute Priority</i> , 1991 Ann. Surv. Am. L. 9 (1992).	36, 37
<i>Webster's New Collegiate Dictionary</i> (6th ed. 1949; 8th ed. 1981)	22

No. 93-714

**IN THE
Supreme Court of the United States**

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,

v.

BONNER MALL PARTNERSHIP,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF OF PETITIONER

OPINIONS BELOW

On December 6, 1991, the United States Bankruptcy Court for the District of Idaho decided to grant U.S. Bancorp Mortgage Company ("U.S. Bancorp") relief from the automatic stay to foreclose on the sole significant asset of Bonner Mall Partnership ("Bonner"). The Bankruptcy Court's Memorandum of Decision is unofficially reported at 1991 Bankr. LEXIS 1402, 1991 WL 330784, and 91 Idaho Bankr.

Ct. Rep. 187 and is reprinted at J.A. 29-33.¹ The Bankruptcy Court entered a separate Order Denying Motion to Dismiss and Granting Motion for Relief from Stay on December 11, 1991. The United States District Court for the District of Idaho reversed the Bankruptcy Court's decision on July 15, 1992 and entered a further Correction Order on July 23, 1992. The District Court's Opinion and Order, as corrected, is reported at 142 B.R. 911 and reprinted at Pet. App. A86-115. That Order was affirmed by the Court of Appeals for the Ninth Circuit pursuant to an Opinion and separate Order filed and entered on August 4, 1993. The Court of Appeals' Opinion is reported at 2 F.3d 899 and reprinted at Pet. App. A1-82.

JURISDICTION

This proceeding arises under the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598 (as amended, the "Bankruptcy Code" or "Code"), 11 U.S.C. § 101, *et seq.* (1993).² The date of the decision of the Court of Appeals for the Ninth Circuit is August 4, 1993. U.S. Bancorp's Petition for Writ of Certiorari was filed on November 2, 1993. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) (1993).

STATUTORY PROVISION INVOLVED

Section 1129 of the Bankruptcy Code provides in relevant part:

¹ A related August 23, 1991 Memorandum of Decision of the Bankruptcy Court was inadvertently printed in place of the December 6, 1991 Memorandum of Decision in the parties' previously filed appendices. See Pet. App. A116-27; Resp. App. A1-7.

² Unless otherwise indicated, all statutory references in this brief are to Title 11 U.S.C.

(a) The court shall confirm a plan only if all of the following requirements are met:

. . .

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan;
or

(B) such class is not impaired under
the plan.

. . .

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

. . .

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

. . .

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

STATEMENT OF THE CASE

This case concerns the ability of Bonner's equity holders to retain their ownership of the Bonner Mall (the "Mall"), a shopping center located in Bonner County, Idaho. The Mall was built by Northtown Investments using a \$6.3 million loan from First National Bank of North Idaho. Northtown Investments signed a note and a deed of trust on the Mall. U.S. Bancorp acquired the note and deed of trust in 1986.

1. Bonner is an Idaho general partnership that was formed for the purpose of acquiring and operating the Mall. On October 31, 1986, Bonner purchased the Mall from Northtown Investments, subject to U.S. Bancorp's lien on the Mall. The Mall is Bonner's only significant asset.

The Mall turned out to be a bad investment and, on July 10, 1990, U.S. Bancorp commenced a nonjudicial foreclosure of the Mall because of Bonner's default under the deed of trust on the Mall. U.S. Bancorp agreed to three requests by Bonner to postpone the foreclosure sale of the Mall, finally resetting the sale for March 14, 1991. On March 13, 1991, Bonner filed a petition under Chapter 11 of

the Bankruptcy Code, staying the foreclosure. *See* § 362(a). Bonner is a debtor-in-possession pursuant to Sections 1101 and 1107.

2. On April 23, 1991, U.S. Bancorp moved for relief from the automatic stay, *see* § 362(d), to foreclose its interest in the Mall on the ground, among others, that Bonner could not confirm a plan of reorganization. On August 23, 1991, the Bankruptcy Court denied relief, subject to the proviso that Bonner propose a plan of reorganization that was not unconfirmable as a matter of law. Pet. App. A127. The Bankruptcy Court also valued the Mall at \$3.2 million. *Id.* at A126.

On October 31, 1991, Bonner filed its First Amended Plan of Reorganization (the "Plan") and related First Amended Disclosure Statement. Under the Plan, which is reprinted at J.A. 2-28, Bonner would transfer all of its assets to a new entity, Bonner Properties, Inc. ("Bonner Properties") in return for Bonner Properties' assumption of Bonner's liabilities as set forth in the Plan.

The Plan provided that the \$3.2 million portion of U.S. Bancorp's claim that is fully secured by the Mall would be paid 32 months after the Plan's confirmation, with 7% annual interest payable monthly in the interim.³ J.A. 11, § 5.3.1.1. Other secured creditors also would be paid the value of their collateral on a deferred basis. J.A. 12-17, §§ 5.3.2-.5. No cash whatsoever would be distributed with respect to the more than \$3.6 million in unsecured claims against Bonner, including the undersecured portion of U.S.

³ Unless U.S. Bancorp exercised its election under Section 1111(b) of the Code, in which case U.S. Bancorp would retain its lien and its entire allowed claim, without interest, would be paid over a period of not less than thirty years. *See* J.A. 12, § 5.3.1.2.

Bancorp's claim which constitutes approximately 93% of all unsecured claims. Instead, all unsecured claims of more than \$1,000 would be satisfied through a pro-rata distribution of 300,000 shares of Bonner Properties redeemable preferred stock having an aggregate par value and liquidation preference of \$300,000. J.A. 17, 19-20, §§ 5.4.1, 7.3. The preferred stock would be convertible after the final payment of the secured portion of U.S. Bancorp's claim into 15% of the then-outstanding shares of Bonner Properties common stock. J.A. 19-20, § 7.3. The preferred stock could be redeemed at Bonner Properties' option at par. *Id.*

Under the Plan, Bonner's existing partners would contribute to Bonner Properties \$200,000 cash and a 32-month undertaking to fund any shortfall in Bonner Properties' working capital in return for 2,000,000 shares (100%) of Bonner Properties common stock. J.A. 19, § 7.2. The Plan would give Bonner's partners the exclusive right to acquire the common stock, except for the 300,000 shares that could be issued to unsecured creditors upon the conversion of the preferred stock.

The Plan does not meet the requirement of Section 1129(b)(2)(B)(i) of the Bankruptcy Code, *see supra* p. 4, because the holders of more than \$3.6 million of unsecured claims are to receive only \$300,000 in liquidation value of preferred stock. Accordingly, the Plan can only be confirmed in a "cramdown" under Section 1129(b) of the Bankruptcy Code if Section 1129(b)(2)(B)(ii) is satisfied. The requirement of Section 1129(b)(2)(B)(ii) embodies what is known as the "absolute priority rule." The Plan appears to violate the absolute priority rule because Bonner's owners will retain property under the Plan, despite the failure to pay unsecured

claims in full.⁴ The Plan therefore can be confirmed only if there is an exception (or corollary) to the absolute priority rule that permits a debtor's owners to contribute new value to the reorganized debtor in return for the property they receive or retain under the plan of reorganization. Bonner relies on such a "new value" exception or corollary to the absolute priority rule to confirm the Plan.⁵

3. In response to Bonner's Plan, U.S. Bancorp renewed its motion for relief from stay to foreclose on its interest in the Mall or for dismissal of the case. *See RA 11.* U.S. Bancorp argued that the Bankruptcy Code does not permit any new value exception to the absolute priority rule and, in the alternative, that if the exception existed, the Plan does not satisfy its requirements as a matter of law. *RA 12,* at 6-11.

The Bankruptcy Court agreed with U.S. Bancorp's first argument and therefore did not reach the second. J.A. 33. The Bankruptcy Court observed that a new value exception under the Bankruptcy Act of 1898 was described in dicta in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), and that this Court had expressly declined to decide whether the exception survived under the Bankruptcy Code in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

⁴ Whether the Plan actually does violate the absolute priority rule is an open question under the decision below. *See Pet. App. A35-43.*

⁵ The Plan has been amended in various regards since the Court of Appeals' decision, but still relies on the new value exception.

J.A. 31-32 & n.5.⁶ In rejecting the exception, the Bankruptcy Court adopted the reasoning of *Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, 948 F.2d 134, withdrawn in relevant part on reh'g and republished as amended, 995 F.2d 1274 (5th Cir. 1991) (per curiam) (Jones, J., dissenting from withdrawal), cert. denied, 113 S. Ct. 72 (1992), and *In re Outlook/Century Ltd.*, 127 B.R. 650 (Bankr. N.D. Cal. 1991). J.A. 32.

The District Court reversed in reliance on this Court's decision in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), see Pet. App. A110-11, which was issued after the Bankruptcy Court's ruling, and apparently found support for its decision in the Fifth Circuit's withdrawal in part of the *Greystone* decision, see Pet. App. A114-15. The District Court reasoned, in light of *Dewsnup* and the District Court's interpretation of the policy underlying Chapter 11, that Congress did not intend to repeal pre-Code practice regarding the new value exception. Pet. App. A111-16. The District Court refused to address the issue whether the Plan satisfies the requirements of the new value exception and remanded to the Bankruptcy Court for that purpose. Pet. App. A116-17.

The Court of Appeals for the Ninth Circuit affirmed the District Court's decision on August 4, 1993. See Pet. App. A1-84.⁷ The Court of Appeals based its affirmance on

four primary grounds: (1) qualifying new value plans do not violate the absolute priority rule because they give old equity a stake in the reorganized debtor on account of its new value contribution, not on account of its old equity interests, Pet. App. A33-51;⁸ (2) Congress' failure to express a clear intent to abandon the new value exception dictates its continued viability, Pet. App. A51-61; (3) Congress' overhaul of the reorganization process does not vitiate the existence of the new value exception, Pet. App. A61-71; and (4) the new value exception is consistent with the policies of Chapter 11, Pet. App. A71-79. The Court of Appeals concluded by remanding the case to the Bankruptcy Court with instructions to consider the feasibility of Bonner's Plan under the new value exception. Pet. App. A81-82.

SUMMARY OF THE ARGUMENT

This case involves "the troublesome phase of construction" in which the Court must determine "the extent to which . . . external circumstances may be allowed to infiltrate the text on the theory that they were part of it, written in ink discernible to the judicial eye." Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 529 (1947). Specifically, the Court must decide whether the "absolute priority rule," which requires that senior creditors be paid in full before junior creditors and interest holders get any property in a cramdown, contains the "new value exception" described in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939). U.S. Bancorp submits that the new value exception was extinguished by Section

⁶ See Argument I of the Brief of the California Bankers Association and the American Bankers Association (hereinafter, the "CBA and ABA") as *Amici Curiae* in Support of Petitioner for the history of the new value exception.

⁷ The Court of Appeals determined as a preliminary matter that the District Court's decision was a final order for purposes of 28 U.S.C. § 158(d) (1993). See Pet. App. A10-19.

⁸ The Court of Appeals identified five requirements for a qualifying new value plan: Value that is "1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful reorganization and 5) reasonably equivalent to the value or interest received." Pet. App. A37 (citing *Los Angeles Lumber*, 308 U.S. at 121-22).

1129(b)(2) of the Bankruptcy Code, the plain language of which provides **without exception** that holders of junior claims and interests may not receive any property under a plan of reorganization unless all senior classes of claims consent to or are unimpaired under the plan. While it is true that Congress did not write the Bankruptcy Code on a clean slate, in completely overhauling the plan confirmation process Congress wrote the new Code with such clarity that it is unnecessary, improper, and ill-advised to refer to what was erased in construing what was enacted.

Accepted rules of Bankruptcy Code construction demonstrate that the new value exception did not survive enactment of the Code. This Court has set forth the applicable method of Bankruptcy Code construction in a line of decisions in which pre-Code practice was claimed to inform Bankruptcy Code interpretation. Those decisions, of which *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989), is the exemplar, hold that the plain meaning of a Code section is controlling unless the plain meaning is intrinsically suspect or extrinsically called into question, such as where there is a clearly contrary expression of legislative intent, a conflicting provision in the Code, or an important, antagonistic, and long-recognized nonbankruptcy policy. See, e.g., *Midlantic Nat'l Bank v. New Jersey Dept. of Envl. Protection*, 474 U.S. 494 (1986). A different or conflicting pre-Code practice alone, however, is not sufficient to justify rejection of the plain meaning of a Bankruptcy Code section. *Dewsnup v. Timm*, 112 S. Ct. 773, 779 (1992). Thus understood, pre-Code practice is a potent tool for the interpretation of ambiguous Code sections, and in those instances where the plain meaning of a section is cast in doubt, but should not be used for construction of sections having a plain and unimpeachable meaning. The Court's decisions further reveal that a statute having a plain meaning is not lightly to be found open to interpretation. See, e.g., *Patterson v. Shumate*, 112 S. Ct. 2242 (1992).

The plain meaning of Section 1129(b)(2)(B)(ii) is that holders of junior classes of claims and interests may not receive any property under a nonconsensual plan of reorganization unless the claims of all nonconsenting senior classes are paid in full. This meaning of the statute cannot be intrinsically or extrinsically impeached. First, the section's plain meaning does not conflict with another part of the Code. Second, the legislative history of the section confirms the plain meaning that, unless senior classes consent to the plan or are paid in full, no junior class can receive anything at all. 124 Cong. Rec. H11,105 (daily ed. Sept. 28, 1978) (remarks of Rep. Don Edwards). And third, there is no important, antagonistic, nonbankruptcy policy—or any other reason—that warrants going beyond the language of Section 1129(b)(2)(B)(ii) to determine the Code's meaning.

The only source of ambiguity allegedly found in Section 1129(b)(2)(B)(ii) is the meaning of the phrase "on account of." But this ordinary phrase has the simple, obvious, and salutary purpose of allowing persons who hold both a junior claim or interest and a senior claim to receive property in a nonconsensual reorganization with respect to the senior claim, though they are barred from receiving property on account of their junior claim or interest unless all objecting senior classes of claims are paid in full. The Ninth Circuit's reading of "on account of" as Congress' invitation to bankruptcy courts to analyze whether a plan gives property to old equity "primarily" because of its old interest or for "legitimate business reasons," see Pet. App. A41-42, should be rejected. Such interpretation finds no support in the Code, its history, or stated intent and would enmesh the courts in an area of economic issues, not legal principles, that Congress intended debtors and creditors to resolve between themselves.

Even if it were appropriate for the Court to refer to pre-Code practice to interpret Section 1129(b)(2)(B)(ii), the

changes in the plan confirmation process from the Bankruptcy Act to the Bankruptcy Code were so substantial that the Court would be justified in disregarding pre-Code practice in interpreting that section. *See Union Bank v. Wolas*, 112 S. Ct. 527 (1991). Congress has now codified the absolute priority rule in a strict form, *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361, *reh'g and reh'g en banc denied* (7th Cir. 1990), and simultaneously eliminated the need for the new value exception, *Lumber Exch. Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exch. Ltd. Partnership)*, 125 B.R. 1000, 1006-07 (Bankr. D. Minn. 1991). As a result of the debtor's enlarged powers under Chapter 11 of the Code, insinuating the new value exception into the Code would create an opportunity for self-dealing where none was present under the Bankruptcy Act, *In re A.V.B.I., Inc.*, 143 B.R. 738, 743 (Bankr. C.D. Cal. 1992), and would skew the careful balance that Congress struck between Chapter 11 debtors and creditors, *In re Greystone III Joint Venture*, 948 F.2nd 134, 144 (5th Cir. 1991) (withdrawn).

ARGUMENT

THE BANKRUPTCY CODE DOES NOT PERMIT A NEW VALUE EXCEPTION

Section 1129(b) can be literally applied to the facts of this case. Section 1129(b)(1) requires that a cram-down plan be "fair and equitable." Section 1129(b)(2) then specifies that: "the condition that a plan be fair and equitable . . . includes the following requirements: . . . the holder of any . . . interest that is junior to the claims of [an impaired class of unsecured claims] will not receive or retain under the plan on account of such junior . . . interest any property." *See supra* pp. 3-4. This language plainly forbids confirmation of a nonconsensual plan that allows the debtor's owners to retain their interests in the debtor if unsecured creditors are not paid in full. Because

the meaning of the statute is plain, and that plain meaning cannot be impeached by evidence of a contrary intent manifested either within or outside of the statute, the statute should not be construed to embody an inconsistent pre-Code practice.

I. Any Pre-Code Practice Recognizing the New Value Exception Is Irrelevant Unless the Plain Meaning of Section 1129(b)(2)(b)(ii) Can Be Intrinsically or Extrinsically Impeached

Construction of Section 1129(b) must begin with the language of the statute itself. *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989) (both citing *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985)). If the statute's language is plain, "'the sole function of the courts is to enforce it according to its terms,'" *Ron Pair*, 489 U.S. at 241 (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)), except "in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" *Id.* at 242 (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)) (alteration in original).

This Court has clearly and consistently articulated the circumstances under which pre-Code practice is relevant to Bankruptcy Code interpretation in a series of decisions commencing with *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494 (1986). These decisions firmly establish that unambiguous Code sections should be applied according to their terms, while ambiguous sections may be interpreted in light of well-recognized pre-Code practices. *See Ron Pair*, 489 U.S. at 242-45.

In *Midlantic* the debtor sought to abandon two properties containing hazardous wastes in violation of state

health and safety laws. 474 U.S. at 497-98. Section 554(a) of the Code purported to permit the abandonment: "After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." The Court refused to accept the text as dispositive of Congress' intent, noting that "when Congress enacted § 554, there were well-recognized restrictions on a trustee's abandonment power. In codifying the judicially developed rule of abandonment, Congress also presumably included the established corollary that a trustee could not exercise his abandonment power in violation of certain state and federal laws." *Id.* at 501. Although the Court did not end its analysis with the Code's text, it did not simply import into the statute the identified pre-Code practice. The Court explained with particularity the manner in which the literal application of Section 554 would conflict with other Code sections requiring the trustee to respect state and local laws designed to protect public health or safety, *id.* at 502-05, and would contradict Congress' goal of protecting the environment against toxic pollution, *id.* at 505-06.

The analysis in *Kelly v. Robinson*, 479 U.S. 36 (1986), followed a similar path. The issue in *Kelly* was whether a restitution obligation imposed as part of a state criminal sentence was dischargeable in Chapter 7 bankruptcy proceedings under Section 523(a)(7) of the Code. *Id.* at 53. First the Court noted that Congress enacted the Code against the backdrop of an established judicial exception to discharge for criminal sentences, including restitution orders. *Id.* at 43-46. Then the Court explained its "deep conviction" that bankruptcy courts should not invalidate the results of state criminal proceedings. *Id.* at 47. "This Court has emphasized repeatedly 'the fundamental policy against federal interference with state criminal prosecutions.'" *Id.* (citation omitted). The Court concluded that there was no evidence in the legislative

history to suggest that Congress intended to reverse such a fundamental policy. *Id.* at 50-53.

Three years later the Court reexamined the *Midlantic* and *Kelly* decisions in *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989). In *Ron Pair* the debtor's plan of reorganization provided for repayment without interest of the United States' tax lien on the debtor's property. *Id.* at 237. The United States objected to the plan on the grounds that the government was entitled to post-petition interest pursuant to Section 506(b) of the Code, which grants the holder of an oversecured claim "interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." *Id.* The Court of Appeals for the Sixth Circuit overruled the government's objection in reliance on *Midlantic* and *Kelly*, observing that prior to enactment of the Code some courts had distinguished between consensual and nonconsensual liens for purposes of determining post-petition interest:

We first reject the Government's contention that pre-Code law should not be relied on in interpreting section 506(b) since the provision appears to be unambiguous. While the language of a statute is always the starting point when its construction is at issue, it is only the starting point. As in [Midlantic] and [Kelly], pre-Code law should be reviewed in order to better understand the context in which the provision was drafted and therefore the language itself.

828 F.2d 367, 369-70 (6th Cir. 1987) (citation omitted). The Court of Appeals then embraced the pre-Code practice of denying post-petition interest on oversecured claims, reasoning that "if there is a well-established principle in bankruptcy law, we believe *Midlantic* and *Kelly* come into play, requiring

Congress to explicitly set forth its intention to deviate from the judicially created rule." *Id.* at 370 n.4.⁹

This Court reversed the Court of Appeals' decision and its rationale. The Court used *Ron Pair* to clarify the context and import of its decisions in *Midlantic* and *Kelly*:

Kelly and *Midlantic* make clear that, in an appropriate case, a court must determine whether Congress has expressed an intent to change the interpretation of a judicially created concept in enacting the Code. But *Midlantic* and *Kelly* suggest that there are limits to what may constitute an appropriate case. Both decisions concerned statutory language which, at least to some degree, was open to interpretation. Each involved a situation where bankruptcy law, under the proposed interpretation, was in clear conflict with state or federal laws of great importance.

489 U.S. at 245. In contrast to the proposed applications of Section 554(a) and Section 523(a)(7) in those cases, the natural interpretation of Section 506(b) in *Ron Pair* did not conflict with any significant state or federal interest, or any other part of the Code. *Id.* Accordingly, the Court found "no reason to

suspect that Congress did not mean what the language of the statute says." *Id.*¹⁰

10

Compare the analogous case of *Harrison v. PPG Indus., Inc.*, 446 U.S. 578 (1980), in which the respondents argued that the phrase "any other final action of the Administrator under [the] Act" in Section 307(b)(1) of the Clean Air Act, 42 U.S.C. § 7607(b)(1), meant less than what its words plainly implied. In support of their narrow interpretation of the Act, the respondents relied on the rule of *ejusdem generis* and the fact that Section 307(b)(1) specifically enumerated certain final actions of the Administrator. Respondents found further support in the silence of the legislative history, which they read as an indication that Congress did not intend the statutory phrase to be literally interpreted because a literal interpretation would radically expand the Courts of Appeals' jurisdiction.

The majority of the Court found a fundamental flaw in respondents' first argument: ""The rule of *ejusdem generis*, while firmly established, is only an instrumentality for ascertaining the correct meaning of words when there is uncertainty." "*Id.* at 588 (citations omitted). Because the majority discerned no uncertainty in the meaning of the phrase "any other final action," *id.*, it refused to apply the *ejusdem generis* canon of construction, *id.* at 589. The majority also refused to read anything into Congress' silence:

[I]t would be a strange canon of statutory construction that would require Congress to state in committee reports or elsewhere in its deliberation, that which is obvious on the face of a statute. In ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark.

Id. at 592 (footnote omitted).

Justices Rehnquist and Stevens both dissented from the majority decision, but in each case identified extrinsic grounds for doubting the plain meaning of the statute. For Justice Rehnquist, the plain meaning would have wrought a jurisdictional expansion "thoroughly inconsistent with the (continued...)

⁹ Compare Pet. App. A53 ("The Bankruptcy Code should not be read to abandon past bankruptcy practice absent a clear indication that Congress intended to do so.") (citing *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990)).

The Court has consistently followed this approach to Bankruptcy Code interpretation and accorded the same weight to pre-Code practice articulated in *Ron Pair* in its subsequent decisions. In *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552 (1990) (criminal restitution obligations not dischargeable debts under Chapter 13), and *Union Bank v. Wolas*, 112 S. Ct. 527 (1991) (long-term debt can qualify for ordinary course of business exception to preference statute), as in *Ron Pair*, the Court refused to consider pre-Code practice in deciding the meaning of the Code sections at issue.¹¹ The only Supreme Court decision

(...continued)

traditional role of appellate courts," resulting in a "massive shift in jurisdiction from the district courts to the courts of appeals." *Id.* at 600 (Rehnquist, J., dissenting). Similarly, Justice Stevens believed that the literal interpretation of the statute would lead to the extraordinary result that the Environmental Protection Agency would have "complete discretion to turn anything it chooses into final action reviewable only in the courts of appeals." *Id.* at 606 (Stevens, J., dissenting).

The positions of both the majority and the dissenters in *Harrison* are consistent with the Court's use of pre-Code practice described in *Ron Pair*. Like *ejusdem generis*, the presumption of continuity is merely an aid to the interpretation of statutes that are ambiguous, or the plain meaning of which has been drawn into question.

¹¹

Some courts have taken the Court's caution in *Davenport* that "We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication the Congress intended such a departure," 495 U.S. at 563, as marking a return to the broad reading of *Midlantic* and *Kelly* exemplified by the Sixth Circuit's reading of those decisions in *Ron Pair*. See, e.g., Pet. App. A53 n.31. These courts have failed to recognize, however, that in *Davenport* the Court concluded that "the statutory language plainly reveals Congress' intent," and refused to apply the *Midlantic/Kelly* principle. 495 U.S. at 563.

since *Ron Pair* to rely on pre-Code practice in interpreting the Bankruptcy Code is *Dewsnup v. Timm*, *id.* at 773 (1992).

In *Dewsnup* the Court considered whether Section 506(d) of the Code allows a Chapter 7 debtor to "stripdown" a creditor's lien on real property and limit the lien to the value of the collateral. *Id.* at 775. Section 506(d) provides that "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void . . ." According to the debtor/petitioner in *Dewsnup*, subsection (d) had to be read in light of Section 506(a), *id.* at 776, which states that "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property."

The majority of the Court stated that it might have agreed with the debtor if it were "writing on a clean slate." *Id.* at 778. The majority observed, however, that "no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Id.* at 779. The Court concluded:

[W]here the language is unambiguous, silence in the legislative history cannot be controlling. But, given the ambiguity here, to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent they become "unsecured" for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles.

Id. Thus, although the Court did refer to pre-Code practice as a guide to interpretation of the Code in *Dewsnup*, which it refused to do in *Ron Pair*, *Davenport*, and *Wolas*, *Dewsnup* is in harmony with *Ron Pair* because the Court only turned to pre-Code practice as a guide *after* finding the statute open to interpretation. *Id.* at 777-79.

In contrast to Section 1129(b)(2)(B)(ii), Section 506(d) was open to interpretation for three legitimate reasons. First, the *Dewsnup* majority expressly found that Section 506(d) and its relationship to other provisions of the Code embraced ambiguities. 112 S. Ct. at 777. Unlike the words and phrases in Section 1129(b)(2)(B)(ii), the meaning of "allowed secured claim" in Section 506(a) is not transparent.¹² Second, the legislative history of Section 506(d) stated that "[Section 506](d) permits liens to pass through the bankruptcy case unaffected," H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 357 (1977), flatly contradicting the plain meaning of Section 506(d) proposed by the petitioner in *Dewsnup*. 112 S. Ct. at 779. Third, the proposed plain meaning would have reversed the long-recognized policy referred to in the House Report that liens created under state law should pass through bankruptcy unaffected (except in successful reorganizations). *Id.* Although this policy is reflected by pre-Code practice, it is actually a substantive *nonbankruptcy* policy of deference to state law that has constitutional ramifications. *See id.* (discussing unconstitutionality of Frazier-Lemke Act).

The approach used in these cases is a sound one that should be expressly reaffirmed—particularly in light of some courts' misreading of the *Dewsnup* decision as changing the

¹² The parties did not even agree on whether "allowed secured claim" was an indivisible compound phrase, as argued by the petitioner, or merely three separate words, as claimed by the respondents and the United States, as *amicus curiae*. *See id.*

process for construction of the Bankruptcy Code in light of pre-Code practice. *See, e.g.*, Pet. App. A110-15; *In re Snyder*, 967 F.2d 1126, 1129 (7th Cir. 1992); *In re Sovereign Group 1985-27, Ltd.*, 142 B.R. 702, 707 (E.D. Pa. 1992); *In re SLC Ltd. V.*, 137 B.R. 847, 852-53 (Bankr. D. Utah 1992). The presumption of continuity between Code and pre-Code practice is merely a means for ascertaining Congress' intent, not an end in itself. In those cases where pre-Code practice has been decisive, it has been so "because it reflected policy considerations of great longevity and importance," *Ron Pair*, 489 U.S. at 245, not because practice under a prior statute is itself so important. Absent such underlying policies, there is no good reason why old laws and practices that Congress has superseded should be reinstated by the courts.¹³

II. The Meaning of Section 1129(b)(2)(B)(ii) Is Plain and Does Not Allow Any Exceptions To the Absolute Priority Rule

A. The Meaning of Section 1129(b)(2)(B)(ii) is Plain and Unambiguous

The language of Section 1129(b)(2)(B)(ii) is clear, using a combination of short, common words in their ordinary sense (holder, junior, receive, retain, under, any, property); words that are defined or have a clearly understood meaning in the Bankruptcy Code (claim, *see* § 101(5); interest, *see*

¹³ As Justice Frankfurter explained, "Statutes come out of the past and aim at the future. They may carry implicit residues or mere hints of purpose. Perhaps the most delicate aspect of statutory construction is not to find more residues than are implicit nor purposes beyond the bound of hints." Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 535 (1947). In this case, the Ninth Circuit has erred by finding residues of pre-Code practice that are not implicit in the Code and purposes that are beyond the legislative intent. *See infra*.

§§ 501(a) & 101(16); plan, *see* §§ 1121-1129); the contextual phrase "such class"; and the common phrase "on account of." The phrase "such class" is clearly a reference to "a class of unsecured claims" in Section 1129(b)(2)(B). The phrase "on account of"—an ordinary phrase that should be given its ordinary meaning, *see Smith v. United States*, 113 S. Ct. 2050, 2054 (1993)—has been consistently defined in dictionaries of common usage for years before and after the Code's enactment in 1978. For example, the phrase was defined in 1949 as "For the sake of; by reason of," *Webster's New Collegiate Dictionary* 6 (6th ed. 1949), and again in 1981 as "for the sake of; by reason of; because of." *Webster's New Collegiate Dictionary* 8 (8th ed. 1981). None of the words in Section 1129(b)(2)(B)(ii) are ambiguous or susceptible to multiple interpretations in the context of the statute.

Section 1129(b)(2)(B)(ii) also employs simple grammar and transparent syntax. In some circumstances, plain words can be combined so as to produce a statute the meaning of which is not plain. *United States v. Monia*, 317 U.S. 424, 431 (1943) (Frankfurter, J., dissenting). In this case, however, the meaning of the words and phrases of the statute is no less clear when they are read together than when they are read in isolation.

As a result of the clear words, phrases and structure used, Section 1129(b)(2)(B)(ii) is susceptible to a single plain or natural meaning: Old equity and junior claim holders may not get or keep anything of value under a Chapter 11 plan unless all senior classes consent or are paid in full. The leading treatise on bankruptcy has adopted this plain meaning: "If a junior class contributes money's worth to the plan and is, thereby, permitted to receive any property or retain an interest, yet a senior class does not receive its full allowed claim, it would appear that the language of section 1129(b)(2) is not

met." 5 *Collier on Bankruptcy* ¶ 1129.03, at 1129-93 (Lawrence P. King ed., 15th ed. 1993).¹⁴

B. The Court of Appeals Rejected the Plain Meaning of Section 1129(b)(2)(B)(ii) Based on an Obvious Error

In its decision below, the Court of Appeals rejected the plain meaning of Section 1129(b)(2)(B)(ii) based in part on its mistaken belief that literal application of the statutory language would render the phrase "on account of such junior claim or interest" superfluous. *See Pet. App. A40-41.*¹⁵

14

It is telling that the courts which abide by the dicta in *Case v. Los Angeles Lumber Prods. Co.* have long referred to the rule in that case as the new value "exception," *see, e.g., Official Creditors' Comm. ex rel. Class 8 Unsecured Creditors v. Potter Material Serv., Inc. (In re Potter Material Serv., Inc.)*, 781 F.2d 99 (7th Cir. 1986); *Anderson v. Farm Credit Bank of St. Paul (In re Anderson)*, 913 F.2d 530 (8th Cir. 1990), implicitly recognizing that any new value doctrine under the Bankruptcy Code would be an exception to the absolute priority rule. *See also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) ("There is little doubt that a reorganization plan in which [debtors] retain an equity interest in the farm is contrary to the absolute priority rule."). *But see Pet. App. A42-43 & n.25* ("new value principle" an extrastatutory doctrine, not an exception to absolute priority rule) and *infra* pp. 28-29 (new value doctrine does not coexist with absolute priority rule).

15

Had Congress intended that old equity never receive any property under a [cramdown] reorganization plan where senior claim classes are not paid in full, it could simply have omitted the "on account of" language from section 1129(b)(2)(B)(ii). We would then be left with an absolute prohibition against former equity owners' receiving or retaining property in the reorganized debtor in such circumstances.

However, the "on account of" phrase serves the simple, obvious, and salutary purpose of allowing persons who hold *both* a junior claim or interest *and* a senior claim to receive property in a nonconsensual reorganization with respect to the senior claim, though they are barred from receiving property "on account of" their junior claim or interest unless all objecting senior classes of claims are paid in full. Had Congress codified the absolute priority rule in the manner suggested by the Ninth Circuit and omitted the "on account of" phrase (leaving the statute to read: "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan any property"), the holder of both a senior claim and a junior claim or interest would be barred from receiving any property under the plan "on account of" its senior claim—although other holders of senior claims could receive property under the plan. The "on account of" language appears to have been calculated to avoid this absurd result.¹⁶ This Court recently underscored the importance of the often subtle distinction under the Code between the treatment of claims and holders of claims in *Nobelman v. American Sav. Bank*, 113 S. Ct. 2106, 2109-10 (1993) (distinguishing between "modification of claims" and "modification of the rights of holders of claims").

C. The Court of Appeals' Interpretation of Section 1129(b)(2)(B)(ii) Is Untenable

The Court of Appeals recognized that "in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners." Pet. App. A38-39. The court went on to state that "it is also true that in new value transactions old equity owners receive stock in exchange for the additional capital they invest." *Id.* at A39. The court therefore sought the answer to the meaning of the statute "in the level of causation Congress had in mind when it prohibited old equity owners from receiving property 'on account of' their prior interests." *Id.* It concluded, without citing any direct authority, that "what Congress had in mind was direct or immediate causation rather than a more remote variety . . ." *Id.* Specifically, the Court of Appeals believed that "Congress intended the 'on account of' phrase in section 1129(b)(2)(B)(ii) to require bankruptcy courts to determine whether a reorganization plan that gives stock to former equity holders does so primarily because of their old interests in the debtor or for legitimate business reasons." *Id.* at A41.

This alternative reading of Section 1129(b)(2)(B)(ii) is untenable. *Nothing* in Section 1129(b) or elsewhere in the Code supports the Court of Appeals' complex interpretation of the "on account of" phrase. The Ninth Circuit frankly admits that a textual search of the Code for a new value exception "dictates its own negative result because such a statutory exception does not exist." Pet. App. A43 n.25 (citation omitted). It seems unlikely that Section 1129 and Chapter 11, which are very detailed and specific, would provide for the new value exception so obliquely and require such an unusual inquiry into levels of causation as that proposed by the Ninth

¹⁶ The legislative history of Section 1129(b) confirms the simple purpose of the "on account of" phrase. *See infra* pp. 32-33.

Circuit without mentioning the exception or providing any guidance as to its scope.¹⁷

If the Court of Appeals' complex interpretation of "on account of" were correct, it also ought to apply to the other instances in which that phrase is used in Section 1129. For example, it should make sense to read Section 1129(b)(2)(B)(i) as stating: "[T]he plan provides that each holder of a claim of

¹⁷

This Court rejected an argument similar to the Ninth Circuit's interpretation of "on account of" in *Regents of the Univ. of Cal. v. Public Employment Relations Bd.*, 485 U.S. 589 (1988). In the *University of California* case the Court examined the "private-hands" exception to the Private Express Statutes, 18 U.S.C. § 1696(c) (1984), which creates an exception to the government's postal monopoly for conveyance of letters by private hands "without compensation." The appellees argued that there would be no "compensation" for carrying certain letters sent through the University's internal mail system because the appellee/union would not pay the University specifically to carry the letters.

The Court observed that, while "compensation" is not defined in the Private Express Statutes, "Congress in no way qualified its reach. We therefore give effect to congressional intent by giving the language its normal meaning." *Id.* at 598. Based on the dictionary definition of "compensation" as an exchange of benefits or a quid pro quo, the Court determined that the appellees gave far too restrictive a reading to the term: "That term includes indirect as well as direct compensation." *Id.* at 600

The Ninth Circuit's distinction in this case between "direct or immediate causation" and "a more remote variety," Pet. App. A39, is the same as the distinction between direct and indirect compensation in the *University of California* case. Congress in no way qualified the reach of the "on account of" phrase in Section 1129(b)(2)(B)(ii), and the Court of Appeals has admitted (as it must) that "in some larger sense" the reason that former owners receive property under new value plans is that they are former owners. *Id.* at A38-39.

[a class of unsecured claims] receive or retain *primarily because of* such claim property of a value . . . equal to the allowed amount of such claim." But such a reading makes little sense and would complicate what is on its face a simple provision. The Court of Appeals has thus rejected a simple meaning of "on account of" that makes sense throughout Section 1129, including in Section 1129(b)(2)(B)(ii), in favor of a complex meaning that arguably might make sense in Section 1129(b)(2)(B)(ii), but fits the rest of the section rather poorly.

Allowing old equity holders to buy the reorganized debtor through a new value plan also would conflict with other sections of the Code. As the court explained in *In re Drimmel*, 108 B.R. 284 (Bankr. D. Kan. 1989), *aff'd*, 135 B.R. 410 (D. Kan. 1991), *aff'd on other grounds sub nom. Unruh v. Rushville State Bank*, 987 F.2d 1506 (10th Cir. 1993), new value exception plans of reorganization represent "a means to sell the property in question without meeting the Bankruptcy Code sales requirements of 11 U.S.C. §§ 363, 1123(a)(5)(D) and 1129(a)(11)." 108 B.R. at 290. *Accord Piedmont Assocs. v. CIGNA Property & Casualty Ins. Co.*, 132 B.R. 75, 80 (N.D. Ga. 1991).

D. The Ninth Circuit's Alternative Interpretation of Section 1129(b)(2)(B)(ii) Does Not Render the Section Ambiguous

The existence of the Court of Appeals' alternative interpretation of Section 1129(b)(2)(B)(ii) does not vitiate the conclusion that the section is susceptible only to the one *plain* meaning set forth above. Words and phrases rarely are so specific as to exclude possible secondary meanings; a statute capable of literal application therefore is not rendered ambiguous by its failure to foreclose other possible interpretations. *See Chisom v. Roemer*, 111 S. Ct. 2354, 2372 (1991) (Scalia, J., dissenting). This Court has thus regularly

found and enforced the plain meaning of Bankruptcy Code sections that have riven lower courts and even divided the Court itself.

For example, in *Patterson v. Shumate*, 112 S. Ct. 2242 (1992), the Court granted certiorari to resolve a conflict among the Courts of Appeals for the Third, Fourth, Sixth, and Tenth Circuits, on the one hand, and the Fifth, Eighth, Ninth, and Eleventh Circuits, on the other, as to whether the phrase "applicable nonbankruptcy law" in Section 541(c)(2) of the Code encompasses relevant nonbankruptcy law, including federal law. *Id.* at 2246 & n.1. Despite the contrary interpretations of the Courts of Appeals, this Court unanimously held that the "plain language" of the Code dictated the answer to the issue. *Id.* at 2246; *accord Rake v. Wade*, 113 S. Ct. 2187 (1993) (applying "plain language of the Code" despite contrary interpretation by Third, Fourth, Ninth, and Eleventh Circuits).

E. The New Value Exception Is Not a Corollary to Section 1129(b)(2)(B)(ii)

Recognizing the absence of any textual support for the new value exception in the Code, the Ninth Circuit reasoned that the so-called "exception" is actually an extra-statutory corollary to the absolute priority rule better described as the "new value doctrine" or "new value principle." Pet. App. A43 & n.25; A3 n.1.

Whether the new value exception coexists with Section 1129(b)(2)(B)(ii) is a question of statutory construction, not a theoretical issue. "'It would be dangerous in the extreme to infer . . . that a case for which the words of an instrument expressly provide, shall be exempted from its operation.'" *Connecticut Nat'l Bank v. Germain*, 112 S. Ct. 1146, 1150 (1992) (quoting *Sturges v. Crowninshield*, 4 Wheat 122, 202 (1819)). Because the "on account of" phrase is a simple

device for distinguishing between classes of claims, not a veiled invitation to conduct causal analysis, *see supra* pp. 23-27 and *infra* pp. 32-33, the Code flatly prohibits old equity from participating in a cramdown plan of reorganization. Accordingly, even if it were possible for courts to determine whether a plan gives old equity a stake in a reorganized debtor "primarily because of" such old interests, or "primarily because of" a new value contribution, *see Pet. App. A39*, the new value "corollary" would still be irrelevant. "Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end." *TVA v. Hill*, 437 U.S. 153, 194 (1978).

III. The Plain Meaning of Section 1129(b)(2)(B)(ii) Is Confirmed By Its Legislative History and Cannot Be Extrinsically Impeached

The *Midlantic* case is a useful example of the point recognized in *Ron Pair* that there are rare cases in which literal application of the Bankruptcy Code's plain language would produce a result demonstrably at odds with the intentions of Congress. Other evidence must therefore be examined to determine whether there is a substantial reason to doubt that the plain meaning of Section 1129(b)(2)(B)(ii) reflects Congress' intent. A review of the legislative history in this case, however, confirms that the plain meaning of Section 1129(b)(2)(B)(ii) is the intended meaning—and further refutes the survival of the new value exception.¹⁸ Examination of the policy implications of literal application of Section 1129(b)(2)(B)(ii) also provides no reason to doubt the plain meaning of the statute.

¹⁸

The history of the new value exception under the Bankruptcy Act, to the extent that it is relevant in this case, provides further support for the plain meaning of the section. *See Brief of CBA and ABA as Amici Curiae in Support of Petitioner, Argument I.*

A. The Plain Meaning of Section 1129(b)(2)(B)(ii) is Supported by the Legislative History of the Code

"There is no conflict between the literal language of section 1129(b)(2)(B) and the legislative history of that section." *In re Outlook/Century Ltd.*, 127 B.R. 650, 656 (Bankr. N.D. Cal. 1991). Like the Code itself, the House and Senate Reports on the Code and the statements of legislative leaders in the House Record and the Senate Record are silent with respect to the new value exception. Kenneth N. Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229, 241 n.99 (1990). Even so, the legislative history of Section 1129(b) reinforces the implication of the text.

In the fullest available explanation of Congress' intent with respect to Section 1129(b)(2)(B)(ii), the sponsors of the Code state:

[U]nder clause (ii), the court must confirm the plan if the plan provides that holders of any claims or interests junior to the interests of the dissenting class of impaired unsecured claims will not receive any property under the plan on account of such junior claims or interests. As long as senior creditors have not been paid more than in full, and classes of equal claims are being treated so that the dissenting class of impaired unsecured claims is not being discriminated against unfairly, the plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) *as long as no class junior to the dissenting class receives anything at all.*

124 Cong. Rec. S17,421 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); 124 Cong. Rec. H11,105 (daily ed. Sept. 28, 1978) (remarks of Rep. Don Edwards) (emphasis added). Similarly, the House Report on the Code states:

The general principle of the subsection permits confirmation notwithstanding nonacceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. The dissenting class must be paid in full before any junior class may share under the plan. . . .

. . . .
The court may confirm over the dissent of a class of unsecured claims . . . only if the members of the class are unimpaired, if they will receive under the plan property of a value equal to the allowed amount of their unsecured claims, or if *no class junior will share under the plan*. That is, if the class is impaired, then they must be paid in full or, if paid less than in full, then *no class junior may receive anything under the plan*.

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 413 (1977) (emphasis added).

The House Report and sponsors' statements are not limited to an explanation of the particular language of the Code; they also explain and illustrate how the confirmation process is supposed to operate. Yet none of their explanations or illustrations makes any reference to the new value exception.

Also notably absent from these statements and the rest of the legislative history is any form of qualifying language, and particularly the "on account of" phrase that the Ninth Circuit invests with such importance. The legislative history thus confirms what the language—and the silence—of the Code plainly suggests: that Congress did not intend the new value exception to operate under the Code.

In addition to supporting the plain meaning of Section 1129(b), these statements subtly demonstrate the simple purpose of the "on account of" phrase by their *omission* of it. The omission suggests, first, that the phrase would have a readily understood meaning that did not require explanation, which is consistent with the literal or plain meaning of the statute. Second, the omission of the "on account of" phrase in each discussion of cramdown in terms of *classes* of claims rather than *holders* of claims suggests that the phrase is unnecessary in relation to classes of claims and interests, but that it is needed in relation to holders of claims and interests. The simple explanation for the "on account of" phrase makes sense of the omission.¹⁹

A precursor of the Code, S. 2266, 95th Cong., 2d Sess. (1977), as amended and reported on August 10, 1978, S. Rep. No. 95-1106, 95th Cong., 2d Sess. (1978), casts further doubt on the Ninth Circuit's interpretation of the "on account of" phrase. Section 1130 of S. 2266 ("Confirmation of plan") provided that a nonconsensual plan could be confirmed only if, with respect to each class that did not accept the plan, "the court shall have determined that a class of claims or interests is not entitled to receive or retain any

¹⁹ On the other hand, there is no reason why the phrase would be less important in relation to classes of claims than to holders of claims if the phrase was intended, as asserted by the Ninth Circuit to determine the level of causation for old equity receiving property under a plan.

participation under the plan, and that no class on a parity with or junior to such class will receive or retain any participation under the plan." *Id.* § 1130(a)(9)(B). The Senate Report on S. 2266 explains: "[I]f a class of [nonaccepting] claims or interests is excluded from participation under the plan, the court may nevertheless confirm the plan if it determines that no class on a parity with or junior to such [class] participates under the plan." S. Rep. No. 95-989, 95th Cong., 2d Sess. 127 (1978).

Although the phrasing and stated intent of Section 1130 of S. 2266 and Section 1129 of the Code are similar, Section 1130(a)(9)(B), which speaks in terms of classes of claims and interests, includes no "on account of" language of any ilk.²⁰ If Congress truly intended the "on account of" phrase to require bankruptcy courts to determine whether a plan gives stock to old equity holders for legitimate or for improper reasons, *see Pet. App. A41-42*, one would expect either to find the phrase in Section 1130(a)(9)(B) or for there to be a statement in the legislative history of Congress' rejection of S. 2266's strict approach to absolute priority.

Finally, the complex interpretation of "on account of" as requiring courts to analyze primary and secondary causal

²⁰ Section 1130(a)(10), however, which speaks in terms of holders, includes the "on account of" phrase: "The plan provides that each holder of a claim of a kind specified in section 507 of this title will receive, on account of such claim, property . . . of a value . . . equal to the allowed amount of such claim . . ." S. 2266 § 1130(a)(10). This reinforces the implication drawn from the legislative history of Section 1129(b)(2)(B)(ii) that the "on account of" phrase is used to clarify sections that are cast in terms of holders of claims and interests, *not* as a signal to examine levels of causation. The use of the phrase in Section 1130(a)(10) also demonstrates that the Senate was familiar with the phrase and knew how to use it.

relationships between junior claims or interests, new value contributions, and property received or retained under a plan is suspect because such analysis would enmesh the courts in an area of economic issues, not legal principles, that Congress intended debtors and creditors to resolve between themselves.²¹ "[T]he Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which fails to honor the absolute priority rule." *Ahlers*, 485 U.S. at 207 (citation omitted).

B. The Plain Meaning of Section 1129(b)(2)(B)(ii) Is Not Contrary to Bankruptcy or Nonbankruptcy Policy

No "fundamental policy" or "extraordinary exemption from nonbankruptcy law" is implicated by the plain language of Section 1129(b)(2)(B)(ii), and literal application of the section has not produced a result "demonstrably at odds" with the presumed intentions of Congress. The Ninth Circuit theorized, however, that strict application of the absolute priority rule would impinge upon the perceived pro-reorganization policy of the Bankruptcy Code referred to in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984), and *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983). Pet. App. A71-76.

As a threshold matter, any pro-reorganization policy is purely a bankruptcy policy, which does not warrant interpretation of an unambiguous Code section. The policies

²¹ In describing confirmation under the Bankruptcy Code, the House Report states that "The procedure followed is simple." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 414 (1977). The new value exception has not proved easy to apply, however, and would significantly complicate the confirmation process. See Brief of the CBA and ABA as *Amici Curiae* in Support of Petitioner, Argument III.B.

involved in the *Midlantic*, *Kelly*, and *Dewsnup* cases, by contrast, were substantive nonbankruptcy policies of great longevity and importance. It is appropriate to accord great weight to nonbankruptcy policies, but little weight to bankruptcy policies embodied in the Code itself, in considering whether Congress meant what it said in the Code. Congress is unlikely to have failed to apprehend that a section of the Code would contradict the purpose of the Code, though it might fail to realize the effect of the Code on other policies.

Even if a competing bankruptcy policy might warrant looking beyond the plain language of the Code, the Court should refuse to do so in this case.

First, this Court has held that Congress sought a balance of creditors' and debtors' rights under the Bankruptcy Code, not to favor debtors in all disputes. "[T]he Bankruptcy Reform Act consolidated three reorganization chapters of the former Bankruptcy Act into a single business reorganization chapter, with the intention that business reorganizations should be quicker and more efficient and provide greater protection to the debtor, creditors, and the public interest. See H.R. Rep. No. 95-595, p. 5 (1977)." *Bildisco*, 465 U.S. at 517 n.1. In *Bildisco* this Court expressly recognized that creditors' interests must be balanced against the debtor's interests and those of other affected parties for a successful reorganization. *Id.* at 527.

The Ninth Circuit's justification for the new value exception also fails on the policy level because strict application of the absolute priority rule in cramdowns does not impair, or even necessarily implicate, debtors' ability to reorganize. New value plans are confirmed with creditors' consent every day. *In re A.V.B.I., Inc.*, 738, 743 (Bankr. C.D. Cal. 1992). Conversely, old equity has a fiduciary duty to protect the interests of the estate, including the interests of creditors as well as equity holders, *Pepper v. Litton*, 300 U.S.

295, 307 (1937), that surely extends to promoting reorganizations whether or not old equity is given a new equity stake in the enterprise. The dispute over the new value exception is thus actually grounded in allocation issues, not reorganization.

As Professor Nimmer explains, "The new value concept is a loss allocation rule" that increases old equity's influence at creditors' expense. Raymond T. Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 Emory L.J. 1009, 1052 (1987).²² Professor Warren recognizes this fact and that reorganizations will take place in most cases with or without either cramdown or the new value exception. Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L. 9, 31-32 (1992). She is opposed to prohibiting old equity from participating in the reorganized debtor pursuant to a strict rule of absolute priority, however, because it "would cause some reorganizations to fail when bargaining breaks down because some creditors overvalue their holdout potential." *Id.* at 32.

Professors Douglas G. Baird and Thomas H. Jackson anticipated and rejected this justification for the new value exception in *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. Chi. L. Rev. 738 (1988): "[N]otwithstanding the costs that everyone suffers if the bargaining breaks down, the bilateral negotiations that follow a default are useful." *Id.* at 755.

One might argue that this conclusion omits the costs of the bargaining process and their potential to lead to the failure of the Firm

²² According to Nimmer, the "primary objective" of bankruptcy is loss allocation. *Id.* at 1010.

as a going concern. One function of bankruptcy law, the response would continue, is to ensure that the failure of even a single creditor and a debtor to reach a bargain that made them both better off would not lead to dismembering of a firm. Bankruptcy, under this view, is a form of binding arbitration that protects the value of the secured creditor's interest and ensures that firms that have a going-concern surplus stay in business.

This argument seems both normatively and descriptively wrong, however. . . .

Although a bargaining impasse might lead to a socially undesirable outcome, neither bankruptcy law nor the absolute priority rule seems an appropriate response to the problem.

Id. at 756, 758.

Bankruptcy should not be used to solve bargaining failures. But if it were, no one knows how many reorganizations might be saved by allowing judges to second-guess the judgment of creditors whom they believe have overvalued their holdout potential. Significantly, however, there is not one reported case of a new value plan being confirmed under the Bankruptcy Act. John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963, 1016 (1989); Kenneth N. Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229, 241 (1990). The impact of the new value exception on the allocation of the "reorganization premium," on the other hand, would be felt in every case because of its effect on the parties' leverage. Warren, *supra*, at 10; Nimmer, *supra*, at 1052.

Assuming that the new value exception would promote reorganizations and that its loss allocation effects were tolerable, it still is by no means clear that allowing new value reorganizations to be crammed down on creditors would prevent the kind of social and economic dislocations that Congress sought to avoid through Chapter 11. "The argument that protecting employees, suppliers or local communities justifies harming creditors . . . should not be lightly accepted and often should be simply disregarded." Nimmer, *supra*, at 1058. "Owners here claim protection as surrogates, but their interests diverge from those of the dependents. Treating the owners as surrogates may convey value to them without benefiting the dependents." *Id.* at 1059.

Although Professor Nimmer was particularly concerned about this problem in the case of publicly held corporations, where there is the greatest divergence between old equity and dependents, the same divergence is true in the case of single-asset debtors like Bonner. The new value problem has been most acute in cases like this involving "single asset" debtors—owners of a mall, an office building or complex,²³ an apartment building,²⁴ or a farm.²⁵ 5 *Collier on Bankruptcy*

²³ E.g., *Greystone*, 995 F.2d 1274; *Travelers Ins. Co. v. Bryson Properties*, XVIII (*In re Bryson Properties*, XVIII), 961 F.2d 496 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992); *Prudential Ins. Co. v. F.A.B. Indus.* (*In re F.A.B. Indus.*), 147 B.R. 763 (C.D. Cal. 1992), appeal docketed, No. 93-55055 (9th Cir. Jan. 13, 1993); *In re SLC Ltd. V.* 137 B.R. 847 (Bankr. D. Utah 1992).

²⁴ E.g., *In re Montgomery Court Apartments, Ltd.*, 141 B.R. 324 (Bankr. S.D. Ohio 1992); *Penn Mutual Life Ins. Co. v. Woodscape Ltd. Partnership* (*In re Woodscape Ltd. Partnership*), 134 B.R. 165 (Bankr. D. Md. 1991); *In re Bjolmes Realty Trust*, 134 B.R. 1000 (Bankr. D. Mass 1991).

²⁵ E.g., *Ahlers*, 485 U.S. 197; *Snyder v. Farm Credit Bank of St. Louis* (*In re Snyder*), 967 F.2d 1126 (7th Cir. 1992);

¶ 1129.03[4][e][i], at 1129-93. In such cases the asset will not liquidate the way a business might: it will merely change hands.²⁶ This case is emblematic of the divergence problem in that the Mall has long been managed by an independent property manager, not Bonner or its employees (it has none), and will continue to stay open irrespective of whether Bonner Properties or U.S. Bancorp owns it.

Ultimately, whether a given reorganization should go forward is a question that Congress left to be decided by creditors, not the courts. The contrary argument advanced by the Ninth Circuit—that new value plans should be favored because they promote all parties' interests through reorganization—is the same claim made by the debtors and rejected by this Court in *Ahlers*. "The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if respondents' reorganization plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code." 485 U.S. at 207 (citation omitted).

(...continued)

Anderson v. Farm Credit Bank of St. Paul (*In re Anderson*), 913 F.2d 530 (8th Cir. 1990).

²⁶ See Brief of the American Council of Life Insurance and Mortgage Bankers Association of America (hereinafter, the "ACLI and MBAA") as *Amici Curiae* in Support of Petitioner at 3-4.

IV. The Bankruptcy Code Changed the Confirmation Process So Fundamentally That Pre-Code Practice Should Be Disregarded

The presumption of continuity of pre-Code practice should not always apply with equal force. Where the need for an old exception dies, its ghost should not haunt the interpretation of subsequent statutes. In this case, even if Section 1129(b) did not unambiguously foreclose the new value exception, the fundamental change in the confirmation process wrought by enactment of Chapter 11 warrants disregard of pre-Code practice as a guide to interpretation of Section 1129(b).

In *Midlantic* the Court properly invoked the presumption of continuity in interpreting the trustee's abandonment power because nothing in the enactment of the Bankruptcy Code had altered the appropriateness of the trustee's adherence to state and local health and safety laws. To the contrary, affirmative evidence in the Code indicated that pre-Code practice retained its vitality. *See supra* p. 14. Similarly, in *Kelly* there was no reason to believe that Congress intended to allow bankruptcy courts to remit state criminal judgments under the Code.²⁷ And in *Dewsnup*, the principle that liens created under state law should pass through bankruptcy unaffected was as sensible in 1978 as it was when *Long v. Bullard*, 117 U.S. 617 (1886), was decided.

But where only bankruptcy interests are at stake and Congress completely rewrites the law, the presumption of continuity is unwarranted. "Importing concepts from past reorganization cases into interpretation of the Code must be done gingerly, with proper attention to the context in which

²⁷ In *Davenport*, on the other hand, the statutory language was so clear that it supported departing from pre-Code practice. *See supra* p. 18 & n.11.

the original case arose." *In re A.V.B.I.*, 143 B.R. 738, 746. This point is demonstrated by the Court's decision in *Union Bank v. Wolas*, 112 S. Ct. 527 (1991), *rev'g In re CHG Int'l, Inc.*, 897 F.2d 1479 (9th Cir. 1990), which underscored the primacy of the Code's plain language over pre-Code practices.

The *Wolas* case involved the Code's "preference" statute and the ordinary course of business defense thereto. Section 547(b) authorizes a trustee to avoid as preferences certain transfers made by a debtor within 90 days before bankruptcy. Preferences also were avoidable by a trustee under the Bankruptcy Act, but the analogous section of the Bankruptcy Act (Section 60, 11 U.S.C. § 96 (1978) (repealed 1979)) did not specifically include an exception for payments made in the ordinary course of business. Instead, courts had developed an exception known as the "current expense" rule to cover payments on the eve of bankruptcy that did not diminish the net estate. 112 S. Ct. at 531. By comparison, as originally enacted in 1978, Section 547(c) of the Code provided in relevant part: "'the trustee may not avoid under this section a transfer— . . . (2) to the extent that such transfer was— (A) in payment of a debt incurred in the ordinary course of business . . . ; (B) *made not later than 45 days after such debt was incurred*'" *Id.* at 530 n.8. In 1984, Congress deleted the italicized language from Section 547(c). *See id.* at 530-31 & n.8.

The debtor in *Wolas* argued, among other things, that Congress intended to codify the judicially created current expense exception under the Bankruptcy Act when it enacted Section 547(c)(2), and therefore the Court should construe the ordinary course of business exception as limited to the confines of that rule. *Id.* at 531. This Court unanimously rejected the debtor's arguments based on the plain language of the statute and the lack of extrinsic evidence indicating an intent to codify the current expense rule. *Id.* at 531-32. The Court then noted

that there had been a number of changes to the preference statute since the current expense rule was adopted:

The current expense rule developed when the statutory preference provision was significantly narrower than it is today. . . . When Congress rewrote the preference provision in the 1978 Bankruptcy Code, it substantially enlarged the trustee's power to avoid preferential transfers At the same time, Congress created a new exception for transfers made in the ordinary course of business. . . .

In light of these substantial changes in the preference provision, there is no reason to assume that the justification for narrowly confining the "current expense" exception to trade creditors before 1978 should apply to the ordinary course of business exception under the 1978 Code. Instead, *the fact that Congress carefully reexamined and entirely rewrote the preference provision in 1978 supports the conclusion that the text of § 547(c)(2) as enacted reflects the deliberate choice of Congress.*

Id. at 532 (citations and footnote omitted; emphasis added).

The same principle applies in this case. With the enactment of the Code, Congress changed the confirmation process even more dramatically than the preference statute.

Chapter 11 under the Bankruptcy Code reflects a melding of concepts derived from several distinct bodies of pre-Code law The conscious purpose expressed in the legislative

history was to create a new chapter that represented the best of all these approaches to reorganization. In other words, Chapter 11 was intended to be different from its pre-Code ancestors.

A.V.B.I., 143 B.R. at 746-47.

A. The Bankruptcy Code Defines What Is "Fair and Equitable"

It is no longer appropriate for judges to apply the new value exception in the exercise of their "informed discretion concerning the practical adjustment of the several rights," *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926), because the Code replaced the judicially developed fair and equitable standard with a statutory definition.²⁸ "Everything changed with the adoption of the Code in 1978. The definition of 'fair and equitable' is no longer a matter of common law; § 1129(b)(2) defines it expressly." *Kham & Nate's Shoes No. 2*, 908 F.2d at 1361; *accord Outlook/Century*, 127 B.R. at 657; *In re Winters*, 99 B.R. 658, 663 (Bankr. W.D. Pa. 1989). "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Ahlers*, 485 U.S. at 206.

²⁸

This is not to say that the "fair and equitable" language in Section 1129(b)(1) does not continue to constitute a separate requirement that a plan must satisfy—beyond the specific requirements set forth in Section 1129(b)(2)—in order to be crammed down on unconsenting classes of creditors. For the reasons argued by the United States in its *amicus* brief, U.S. Bancorp believes that the "fair and equitable" standard in Section 1129(b)(1) presents an independent basis for rejecting any new value "exception" under the Code: a plan allowing participation by old equity owners over the objections of unpaid creditors is not "fair and equitable."

B. The Bankruptcy Code Liberalized the Confirmation Process, Obviating the Need for a New Value Exception

As explained in *Lumber Exch. Ltd. Partnership v. The Mut. Life Ins. Co. of N.Y. (In re Lumber Exch. Ltd. Partnership)*, 125 B.R. 1000 (Bankr. D. Minn. 1991):

Under the *Bankruptcy Act*, a plan could be confirmed only if it was "fair and equitable" to each dissenting creditor. . . .

The *Bankruptcy Code* refocused the concept "fair and equitable" away from dissenting creditors and onto dissenting classes. . . . Application of absolute priority rule exceptions to creditor members of a rejecting class was never discussed in cases decided under the *Bankruptcy Act*. In fact, the required finding of fair and equitable was applicable only to the dissenting minority creditors belonging to an accepting class.

Class acceptance by requisite percentage approval, and a finding of "fair and equitable" regarding minority dissenting creditors of the same class, were both required to obtain confirmation under the *Bankruptcy Act*. Accordingly, the absolute priority rule was not applicable to a rejecting class. Class acceptance was a condition precedent to application of the rule.

. . . [I]t is by no means certain that the "new value" exception to absolute priority, when considered with respect to a rejecting class under the *Code*, would measure the same equitable strength as when applied to *individual dissenters* of an accepting class under the *Bankruptcy Act*. . . . As used under the *Act*, the exception did not collide with the absolute priority rights of the class. Application of the exception under the *Code* would eviscerate those rights.

Id. at 1006-07 & n.10 (citations omitted). As a result of this liberalization, the new value exception is not needed under the Code. "Holdouts that spoiled reorganizations and created much of the motive for having judges 'sell' stock to the manager-shareholders no longer are of much concern, now that § 1126(c) allows the majority of each class (two-thirds by value) to give consent." *Kham & Nate's Shoes No. 2*, 908 F.2d at 1361.²⁹ "Consensual 'new value' plans involving cash infusions by existing management or equity are an extremely common and effective means of resolving chapter 11 cases." *A.V.B.I.*, 143 B.R. at 743.

Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939), illustrates this point. The petitioners in *Los Angeles Lumber* were the holders of just over 7% of a class of the debtor's bonds. They objected to the debtor's plan on the grounds that it was not fair and equitable to bondholders, even though the holders of almost 93% of the bonds had consented

²⁹

The *amicus* brief of the CBA and ABA further explains that the new value exception under the Act was created and used for the benefit of majority/consenting creditors—not by old equity. *See Brief of CBA and ABA as Amici Curiae in Support of Petitioner, Argument I.B.*

to the plan. *Id.* at 112.³⁰ If the *Los Angeles Lumber* plan were before the Court today, it could be confirmed without resort to the cramdown provisions of Section 1129(b). *Outlook/Century*, 127 B.R. at 657.³¹

C. The Code Enlarged the Powers of Debtors' Management and Owners

One reason why the new value exception was less troubling under the Bankruptcy Act was that old equity holders had far less ability to abuse the exception under the Act than they have under the Code. As the court explained *In re A.V.B.I.*:

Perhaps the key difference between the Code's chapter 11 and the statutory context of

³⁰ The district court confirmed the plan and approved the issuance of new common stock to the old equity holders on the grounds, among others, "that they had furnished the bondholders certain 'compensating advantages' or 'consideration' in the form of "'their familiarity with the operation' of the business and their 'financial standing and influence in the community'; and because they can provide a 'continuity of management.'" *Id.* at 112-13 (quoting the district court). The Court of Appeals for the Ninth Circuit affirmed the decision without reaching the merits of the case. *Id.* at 113. This Court reversed, recognizing the new value exception in dicta, but holding that the contribution of new value must be "in money or in money's worth," *id.* at 122, and that the debtor's plan did not satisfy that standard.

³¹ The same is true of the other cases cited by the Court of Appeals at Pet. App. A27 in which this Court has adverted to a new value exception. See *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536 (1946) (owners of 92% of bonds assented to new value plan); *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78 (1942) (over two-thirds of certificate holders consented to readjustment plan).

the *Los Angeles Lumber* case is the debtor in possession concept and its implications. All Section 77B cases had court-appointed trustees in place: the debtors did not control the management of the company during the administration of the case. By contrast, under the Bankruptcy Code, chapter 11 cases overwhelmingly are operated by debtors in possession. Thus, a "new value" exception under Section 77B might have appeared obviously unobjectionable to the Supreme Court in *Los Angeles Lumber* because equityholders would only be allowed to buy back into the management of the company, after a trustee had been in place. . . . On the other hand, in a chapter 11 debtor in possession case, a "new value" exception permits uninterrupted control by insiders.

143 B.R. at 743. This change creates a potential for abuse of the new value exception unlike any under the Bankruptcy Act.³²

D. The New Value Exception would Skew the Code's Balance between Debtors and Creditors by Injecting the Courts into Disputes that Congress Left to the Parties

The new value exception is entirely inconsistent with Congress' careful realignment of creditors' rights and powers under Section 1129(b). "A 'new value exception' means a power in the judge to 'sell' stock to the managers even when

³² See Brief of the ACLI and MBAA as *Amici Curiae* in Support of Petitioner at 18-20.

the creditors believe that this transaction will *not* augment the value of the firm." *Kham & Nate's Shoes No. 2*, 908 F.2d at 1360.

[P]ermitting the courts, pursuant to a "new value exception," rather than the creditors, under a strict absolute priority rule, to determine the conditions of former equity owners' participation in a reorganized debtor introduces an enormously complicating factor in a carefully balanced bargaining structure.

. . . Creditors and the debtor [would be] left to guess, *not what each other's* "bottom line" position is for a consensual plan, *but rather what the particular court sees* as a "bottom line" cash contribution that will permit cramdown of an old equity plan under the "new value exception." . . . Negotiations between creditors and the debtor against such a "new value exception" backdrop would be enormously skewed in favor of old equity and would seriously erode the utility of the creditors' votes.

In re Greystone III Joint Venture, 948 F.2d at 144 (withdrawn). But "the Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which fails to honor . . . the absolute priority rule." *Ahlers*, 485 U.S. at 207 (citation omitted).

* * *

In light of these substantial changes, reliance on pre-Code confirmation practices would be unwarranted in this case, even if Section 1129(b) were open to interpretation. The Court therefore should follow its reasoning in *Union Bank v.*

Wolas and refuse to use pre-Code practice as a guide to the meaning of Section 1129(b)(2)(B)(ii).³³

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals should be reversed and the decision of the Bankruptcy Court and order granting U.S. Bancorp relief from the automatic stay to foreclose on the Mall should be reinstated.

Respectfully submitted,

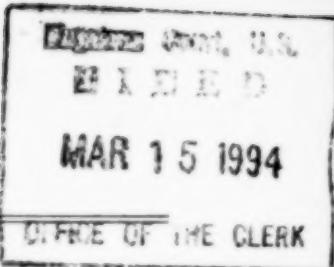
Bradford Anderson*
Dale G. Higer
David B. Levant
*Counsel of Record

STOEL RIVES BOLEY JONES & GREY
3600 One Union Square
600 University Street
Seattle, WA 98101-3197
(206) 624-0900

Counsel for Petitioner

³³

In the alternative, the decision below should be reversed because, as the United States and the ACLI and MBAA explain in their *amicus* briefs, Bonner's Plan violates Section 1129(b)(2)(B)(ii) by giving Bonner's owners an exclusive right to acquire the common stock of Bonner Properties.



In The
Supreme Court of the United States
October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,
v.

BONNER MALL PARTNERSHIP,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

**MEMORANDUM OF RESPONDENT SUGGESTING
THAT THE CASE IS MOOT**

BARBARA BUCHANAN
JOHN FORD ELSAESSEN, JR.

Counsel of Record

ELSAESSER JARZABEK &
BUCHANAN, CHTD.
Third & Lake Streets
P.O. Box 1049
Sandpoint, ID 83864
(208) 263-8517
Counsel for Respondent

Bonner Mall Partnership, the Respondent in the above-captioned case files this memorandum to advise the Court of certain facts which render this cause moot.

The question presented in this case is as follows:

Whether the new value exception to the absolute priority rule survived enactment of the Bankruptcy Reform Act of 1978, permitting the debtor in the Chapter 11 bankruptcy case to confirm a nonconsensual plan of reorganization that allows the debtor's equity holders to retain ownership of the reorganized debtor while paying objecting creditors less than the full amount of their claims.

On January 7, 1994, the Petitioner, U.S. Bancorp Mortgage Company and the Respondent, Bonner Mall Partnership, reached a tentative settlement of this case subject to certain conditions to be performed by Bonner Mall Partnership and its partners. This Court granted its Writ of Certiorari on January 10, 1994.

The Bonner Mall Partnership and its partners performed its required obligations, and on March 2, 1994, U.S. Bancorp and Bonner Mall Partnership stipulated to the confirmation of a consensual plan of reorganization, which also received the consent of all other creditors.

On March 10, 1994, the United States Bankruptcy Court for the District of Idaho entered an Order Confirming Chapter 11 Plan. A true copy of this Order is attached hereto as Exhibit "A". The plan confirmed by this Order, Bonner Mall Partnership's Third Amended Plan of Reorganization is attached hereto as Exhibit "B".

The confirmed Plan of Reorganization, stipulated to by Petitioner and Respondent, does not involve or address issues under 11 U.S.C. § 1129(b). No questions involving the "new value exception" to the absolute priority rule are raised by the stipulated plan of reorganization, which, in any case, was consented to by all creditors.

The Respondent and the Petitioner having settled all matters at issue between them, and there no longer being an issue concerning the new value exception or a nonconsensual plan of reorganization, it is respectfully suggested that the case is moot, and should be dismissed pursuant to Rule 46 of the Rules of the Supreme Court of the United States.

Respectfully submitted this 14th day of March, 1994.

JOHN FORD ELSAESSER, JR.,
Attorney for Respondent
BONNER MALL PARTNERSHIP

EXHIBIT A

Ford Elsaesser
Barbara Buchanan
ELSAESSER, JARZABEK, BUCHANAN
AND DRESSEL
P.O. Box 1049
Sandpoint, ID 83864-0855
(208) 263-8517

UNITED STATES BANKRUPTCY COURT DISTRICT OF IDAHO

In Re:	)	Case No. 91-00801
BONNER MALL)	
PARTNERSHIP	)	ORDER CONFIRMING
Debtor,	)	CHAPTER 11 PLAN

The Third Amended Plan of Reorganization filed with this court on March 10, 1994, having been transmitted to creditors and equity security holders and:

1. The plan having been accepted in writing or in open court on the record by the creditors and equity security holders whose acceptance is required by law; and
2. The provisions of Chapter 11 have been complied with; the plan has been proposed in good faith and not by any means forbidden by law; and
3. (i) Each holder of a claim or interest has accepted the plan or will receive or retain under the plan property of a value, as of the effective date of the plan, that is not less than the amount that such holder would receive or

App. 2

retain if the debtor were liquidated under Chapter 7 of the code on such date, or (ii) the plan does not discriminate unfairly, and is fair and equitable with respect to each class of claims or interest that is impaired under, and has not accepted the plan; and

4. All payments made or promised by the debtor or by a person issuing securities or acquiring property under the plan or by any other person for services or for costs and expenses in, or in connection with, the plan and incident to the case, have been fully disclosed to the court and are reasonable or, if to be fixed after confirmation of the plan, will be subject to approval of the court; and

5. The identity, qualifications, and affiliations of the persons who are to be directors or officers, if any, of the debtor after confirmation of the plan have been fully disclosed, and the appointment of such persons to such offices, or their continuance therein, is equitable, and consistent with the interests of the creditors and equity security holders and with public policy; and

6. The identity of any insider that will be employed or retained by the debtor and his compensation have been fully disclosed; and

7. Confirmation of the plan is not likely to be followed by the need for further financial reorganization of the debtor.

IT IS HEREBY ORDERED that the Third Amended Plan of Reorganization is confirmed with the following modifications in regard to the treatment of creditors U.S. Bancorp, D. L. Evans Bank, and First Security Bank as set

App. 3

forth in the stipulations executed by Debtor and those creditors and filed herewith.

1. U.S. Bancorp. The final sentence of the second full paragraph on page 11 of the Third Amended Plan of Reorganization is modified to read as follows:

"This reserve account shall be held in interest-bearing account by the property manager of the Bonner Mall at U.S. Bank."

The last line of the third full paragraph on page 11 of the Third Amended Plan of Reorganization should read as follows:

"However, nothing in the agreement by U.S. Bank to accept treatment under the Plan, or in any of the agreements between U.S. Bank, the debtor, and the guarantors, shall be construed to release, waive, or impair the claim that U.S. Bank has against the original Northtown Partners, including Lloyd Andrews, based upon the guaranties of said partners or applicable partnership law."

2. D. L. Evans Bank. Paragraph 5.3.5.1 located at page 16 of the Third Amended Plan of Reorganization should be modified to change the amount of monthly cash to D. L. Evans Bank from \$3,851.00 to \$3,581.10 and to change the interest rate from seven percent per annum to a variable rate of two percent over the prime rate as published in the Wall Street Journal. In addition, the following language should be included:

"D.L. Evans Bank shall continue to retain the guaranty of H.F. Magnuson and any security pledged as security for such guaranty until such

App. 4

time as debtor's obligations under the Note are paid in full."

3. First Security Bank. Paragraph 5.3.2.1 dealing with the treatment of the Class 2b Creditor, First Security Bank should be modified to provide as follows:

5.3.2.1 The holder of the Class 2b claim, First Security Bank, N.A. ("First Security") is fully secured and should be treated as follows:

Debtor is obligated to First Security under two promissory notes ("the Notes"), Note No. 00026 and Note No. 0018. The Notes have a maturity date of September 15, 1995.

Debtor shall continue to make payment to First Security on a monthly basis in accordance with the terms and conditions of the Notes. These payments are Note No. 00026: Five Thousand Four Hundred Dollars (\$5,400.00); and Note No. 0018 One Thousand Thirty Two and 19/100 Dollars (\$1,032.19) per month. The payments will be made on or before the fifteenth day of each month to and until September 15, 1995 at which time all principal, accrued interest and costs then outstanding shall be due and payable.

First Security shall continue to retain its first deed of trust on the unimproved property adjacent to the Bonner Mall (the "Subject Property"). Nothing herein shall be deemed to impair or otherwise restrict the lien of First Security's deed of trust. First Security acknowledges that debtor may grant US Bank a second deed of trust on the Subject Property. First Security hereby consents to debtor's grant of lien to US Bank which is junior and subordinate to First Security's deed of trust on the Subject Property.

App. 5

First Security shall continue to retain the guaranties of H.F. Magnuson and Lloyd Andrews, and any security pledged as security for such guaranties until such time as debtor's obligations under the Notes are paid in full.

Upon default of any of debtor's obligation to make payment under either of the Notes, payment of real property taxes, insurance, or other provisions of the deed of trust in favor of First Security, which default remains uncured for a period of thirty (30) days, First Security shall be entitled to immediately initiate proceedings to foreclose its deed of trust without obtaining the consent of the bankruptcy court.

Debtor agrees that First Security may add the cost of any real property appraisal which it is required by regulation to obtain, to the principal balance of the Notes. The cost of any such appraisal(s) shall be payable upon maturity of the Notes, September 15, 1995.

Debtor acknowledges and agrees that First Security is a fully secured creditor and pursuant to 11 USC Section 506(b) and the terms and conditions of its deed of trust and Notes is entitled to reimbursement of its attorney's fees and costs incurred in this bankruptcy proceeding. First Security shall add the amount of its attorney's fees and costs to the principal balance of the Notes and such sum shall be payable upon maturity of the Notes, September 15, 1995.

Guarantors shall provide to First Security within ninety (90) days from the end of each calendar year copies of their personal financial statements (balance sheet, income statement and income tax returns) prepared in accordance with

generally accepted accounting standards consistently applied in a form acceptable to First Security. Debtor shall provide copies of its company prepared monthly financial statements, to First Security within fifteen (15) days from the end of each month and a copy of its annual financial statements prepared in accordance with generally accepted accounting standards consistently applied, within ninety (90) days after year end.

DATED this 10 day of March, 1994.

/s/ Alfred C. Hagan
Alfred C. Hagan
U.S. Bankruptcy Judge

Presented by:

/s/ Ford Elsaesser
Ford Elsaesser, Attorneys for
Debtor-in-Possession

Ford Elsaesser
Barbara Buchanan
ELSAESSER, JARZABEK &
BUCHANAN, CHTD
P. O. Box 1049
Sandpoint ID 83864
(208) 263-8517

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO

In Re:	)	Case No. 91-00801
BONNER MALL	)	THIRD AMENDED
PARTNERSHIP,	)	PLAN OF
Debtor.	)	REORGANIZATION

Bonner Mall Partnership, an Idaho general partnership, the Debtor in the above-captioned Chapter 11 case, proposes the following Plan of Reorganization pursuant to Subchapter II of Chapter 11 of the Bankruptcy Code:

ARTICLE I
DISCLOSURE STATEMENT

1. The Debtor has filed a Disclosure Statement pursuant to 11 U.S.C. § 1125 and Bankruptcy Rule 3016(c). The Disclosure Statement has been approved by the Bankruptcy Court prior to this Plan being submitted to creditors and equity security holders. The Disclosure Statement provides useful information to aid and assist creditors and equity security holders in voting on the Plan. YOU ARE URGED TO READ THE DISCLOSURE

STATEMENT WITH CARE IN EVALUATING THE
IMPACT OF THE PLAN UPON YOUR CLAIMS OR
EQUITY SECURITY INTERESTS.

ARTICLE II
DEFINITION OF TERMS

2. A term used in this Plan that is not defined below and that is defined in the Bankruptcy Code shall have the meaning ascribed in the Bankruptcy Code. When used in this Plan, the following terms shall have the meanings specified below, unless the context otherwise requires:

2.1 ALLOWED CLAIM: Any claim in the amount and of the priority classification set forth in the proof of such claim that has been filed timely in the Reorganization Case, or in the absence of such proof, as set forth in the Debtor's schedules of liabilities filed in the Reorganization case, unless: (i) such claim has been listed in such schedules as disputed, contingent, or unliquidated, in which case such claim shall be allowed only in such amount and such classification as is authorized by Final Order of the Bankruptcy Court; (ii) such claim has been objected to or is objected to after Confirmation, in which case such claim shall be allowed only in such amount and such classification as if authorized by Final Order of the Bankruptcy Court; or, (iii) such claim has been paid in full, withdrawn, or otherwise deemed satisfied in full.

2.2 ALLOWED INTEREST: Any Equity Interest in the amount and of the priority classification set forth in the proof of such Equity Interest that has been filed timely in the Reorganization Case, or in the absence of

such proof, as set forth in the debtor's listings and schedules filed in the Reorganization Case, unless: (i) such Equity Interest has been objected to or is objected to after confirmation, in which case such Equity Interest shall be allowed only in such amount and such classification as is authorized by Final Order of the Bankruptcy Court; or (ii) such Equity Interest has been paid in full, withdrawn, or otherwise deemed satisfied in full or retired.

2.3 AS SOON AS PRACTICABLE: Unless extended by court order, within thirty days following the occurrence of a triggering event.

2.4 BANKRUPTCY CODE or CODE: The Bankruptcy Code enacted November 6, 1978, as set forth in Title 11 of the United States Code, and as amended thereafter.

2.5 BANKRUPTCY COURT or COURT: The United States Bankruptcy Court for the District of Idaho, before which the Reorganization Case is pending, or if that Court ceases to exercise jurisdiction over the Bankruptcy Case, the Court that does exercise jurisdiction.

2.6 CLASS: A class of claims or equity security interests as defined in Article III of this Plan.

2.7 CLASS 3 CLAIMS ORDER: The order of the Bankruptcy Court making specific reference to this Plan which fixes and liquidates the amount of all Class 3 claims.

2.8 CONFIRMATION: The entry of the Order of Confirmation by the Bankruptcy Court.

2.9 DEBTOR: Bonner Mall Partnership, an Idaho partnership.

2.10 DISPUTED CLAIM: A filed or scheduled claim of an alleged creditor as to which an objection has been filed by a party in interest.

2.11 EFFECTIVE DATE: A date eleven days after Confirmation unless the effect of the Order of Confirmation is stayed under Bankruptcy Rule 8005.

2.12 ESTATE: The Estate created pursuant to § 541 of the Bankruptcy Code.

2.13 FINAL ORDER: An order of the Bankruptcy Court confirming the Plan pursuant to Section 1129 of the Bankruptcy Code.

2.15 PETITION DATE: March 13, 1991, the date upon which the Debtor filed the Chapter 11 Petition commencing the Reorganization Case.

2.16 PLAN: This Plan of Reorganization in its present form or as it may be amended or modified from time to time pursuant to order of the Bankruptcy Court.

2.17 PROFESSIONAL PERSONS: Persons retained or to be compensated pursuant to §§ 326, 327, 328, 330 and/or 1103 of the Bankruptcy Code.

2.18 PRO RATA: Proportionally so that the ratio of the amount distributed on account of a particular Allowed Claim to the amount of such Allowed Claim is the same as the ratio of the amount distributed on account of all Allowed Claims in the Class of which such particular Allowed Claim is a member to the total amount of all Allowed Claims in such Class.

2.19 REORGANIZATION CASE: Chapter 11 case pending before the Bankruptcy Court commenced by the Debtor, designated Case No. 91-00801.

2.20 REORGANIZED DEBTOR: As provided by § 1141(b) of the Bankruptcy Code, Bonner Mall Partnership, an Idaho general partnership as reconstituted, in accordance with the provisions of this Plan following the Effective Date, with assets that were formerly property of the Estate.

2.21 SECURED CLAIM: An Allowed Claim that is a secured claim against the Debtor determined in accordance with §§ 506 and 552 of the Bankruptcy Code.

2.22 UNCLASSIFIED CLAIM: An Allowed Claim described in § 507(a)(1), (2) or (7) of the Bankruptcy Code and any fees payable pursuant to 28 U.S.C. § 1930.

2.23 UNSECURED CLAIM: An Allowed Claim that is not a Secured Claim.

ARTICLE III

CLASSIFICATION OF CLAIMS AND INTERESTS

3. All claims, as defined in § 101(5) of the Bankruptcy Code, against the Debtor and all equity security interests, as defined in § 101(16) of the Bankruptcy Code, in the Debtor are classified as set forth herein. A claim or interest is in a particular Class only to the extent it qualifies within the definition of such Class and is in a different Class to the extent it qualifies within the definition of such different Class.

3.1 Priority Claims:

3.1.1 Class 1: All Allowed Claims against the Debtor entitled to priority pursuant to § 507(a)(3) of the Bankruptcy Code.

3.2 Secured Claims:

3.2.1 Class 2a: The Secured Claim of U. S. Bank, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.2 Class 2b: The Secured Claim of First Security Bank, formerly First National Bank of North Idaho, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.3 Class 2c: The Secured Claim of Panhandle State Bank, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.4 Class 2d: The Secured Claim of Triangle Development, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.2.5 Class 2e: The Secured Claim of D. L. Evans Bank, secured by property of the Estate, which property will be vested in the Reorganized Debtor in accordance with Paragraph 7.1.

3.3 Unsecured Claims.

3.3.1 Class 3a: All Allowed Claims against the Debtor, however arising, not entitled to priority and not

otherwise included in any other Class hereof, including, without limitation, claims based upon the rejection of executory contracts or unexpired leases.

3.3.2 Class 3b: Any Allowed Claims of Lloyd Andrews, H. F. Magnuson and the Debtor's partners which are not Unclassified Claims, which are not entitled to priority and which are not otherwise included in any other Class hereof.

ARTICLE IV

CLAIMS AND INTERESTS NOT IMPAIRED BY THE PLAN

4. The Allowed Claims in Class 1 are not impaired under the Plan.

ARTICLE V

PROVISIONS FOR SATISFYING CLAIMS AND SPECIFYING TREATMENT OF EACH CLASS UNDER THE PLAN

5. The treatment of all Allowed Claims and Allowed Interests are specified as follows:

5.1 *Unclassified Claims:* Unclassified Claims, upon allowance by the Court will be paid as follows:

5.1.1 Each holder of an Allowed Claim entitled to priority pursuant to § 507(a)(1) of the Code shall receive, from the Reorganized Debtor, as soon as practicable following the later of (a) the Effective Date of (b) the date upon which an order of the Court allowing such claim becomes a Final Order, cash in the amount of such

Allowed Claim unless the holder of such Unclassified Claim agrees to different treatment, except for certain ordinary course of business Unclassified Claims, the treatment of which is specified in Paragraph 5.1.2 below; provided that all fees payable pursuant to 28 U.S.C. § 1930 shall be paid prior to or on the Effective Date.

5.1.2 Unclassified Claims incurred by the Debtor during the pendency of the case shall be assumed and paid in the ordinary course of business by the Reorganized Debtor after the Effective Date.

5.1.3 Allowed Claims of governmental units entitled to priority pursuant to § 507(a)(7) of the Code and not otherwise included in any other Class hereof shall be paid by the Reorganized Debtor in twelve (12) equal quarterly cash payments commencing on the final day of the first full fiscal quarter of the Reorganized Debtor following the later of (a) the Effective Date or (b) the date upon which an order of the Court allowing such claim becomes a Final Order, and amortized with interest over such twelve quarter period. The amortization shall be based on simple interest at a rate equal to seven percent (7%) per annum unless the Court establishes, after notice and a hearing, a different market rate of interest. Any holder of a claim entitled to priority under § 507(a)(7) shall, within the same deadline and in the same manner established for objections to confirmation, file any objection it may have to the proposed interest rate, identify the proposed alternative rate, and set forth the facts and circumstances justifying such rate. Failure to object to the proposed interest rate shall be deemed to be a consent thereto. The holder of an Allowed Claim entitled to priority pursuant to § 507(a)(7) of the Code shall not be

entitled to receive any payment on account of any Post-Petition Date penalty or interest with respect to or arising in connection with its claim; and any such claim or demand for Post-Petition Date penalties or interest shall be discharged by Confirmation of this Plan under 1141(d)(1) of the Code, and the holder of such claims shall not assess or attempt to collect such penalty or interest from the Reorganized debtor. As of the date of this Second Amended Plan of Reorganization, the Debtor is unaware of any past due, unpaid, or delinquent claims that would fit under this category.

5.2 Priority Claims:

5.2.1 *Class 1:* Class 1 claims are not impaired under this Plan. Each holder of a Class 1 Allowed Claim shall be paid the entire amount of such holder's Allowed Claim by the Reorganized Debtor on the later of (a) the Effective Date or (b) the date upon which an order of the Court allowing such claim becomes a Final Order.

5.3 Secured Claims:

5.3.1 *Class 2a:* The holder of the Class 2a claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2a claim otherwise agree to alternative treatment of the claim, the Class 2a Claim shall be satisfied in the manner described in Paragraph 5.3.1.1 below, or if U. S. Bank properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2a claim shall be satisfied in the manner described in Paragraph 5.3.1.2 below.

5.3.1.1. U. S. Bank, the holder of the Secured Claim constituting the Class 2a claim, shall upon confirmation

make a new loan to the Partnership in the amount of \$4.3 million dollars. The loan shall carry interest at the rate of 8.75 percent per annum and shall be payable over five (5) years with monthly payments of principal and interest based on a twenty five (25) year amortization.

The debtor or its guarantors shall provide a "take out" commitment for permanent financing to U.S. Bank by the forty-ninth month of the term of the loan. The new loan shall act as payment of the secured claim of U.S. Bank in the amount of 3.2 million dollars and the loan made by U.S. Bank to H.F. Magnuson and Lloyd Andrews for the expansion of Yoke's Pac 'n' Save, commonly referred to as the "\$905,000" loan, in the amount of 1.1 million dollars. The law suit in the First Judicial District of the State of Idaho, in and for Bonner County (hereinafter "Bonner County District Court") between U.S. Bank, H.F. Magnuson, and Lloyd Andrews, Case No. CV 92-01127, shall be dismissed, with prejudice, with each party bearing its own attorney fees and costs. In addition U.S. Bank will agree to dismiss its claims against Yoke's Washington Foods, Inc. filed in the Bonner County District Court, as Case No. CV 92-01332.

To secure the new loan in the amount of 4.3 million dollars, U.S. Bank shall receive a first position security interest in the Bonner Mall property it currently holds as collateral, with an assignment of all rents. In addition, the loan shall have as additional collateral the 4100 acres commonly referred to as the "Athol" property owned by H. F. Magnuson. Further, U.S. Bank shall have as additional collateral a first position deed of trust on the residence of Lloyd Andrews. In addition, the Bank shall be granted a junior lien on property owned by the debtor

adjacent to Bonner Mall, secured by a first lien to First Security Bank. U.S. Bank will agree to release said lien on this parcel only, to the extent justified by commercially reasonable development of said parcel.

For the entire amount of the new loan of 4.3 million dollars, U.S. Bank shall receive the personal guaranty of H. F. Magnuson and of Lloyd Andrews.

The Bonner Mall Partnership shall keep a reserve account with a minimum balance of no less than \$100,000, for unanticipated expenses and repairs. Should this fund need to be drawn down, it shall be brought back up to a \$100,000 balance within thirty days of such draw down. This reserve account shall be held in an interest-bearing account by the property manager of the Bonner Mall.

U.S. Bank shall receive no payment upon its unsecured deficiency claim. However, nothing in the agreement by U.S. Bank to accept treatment under the Plan, or in any of the agreements between U.S. Bank, the debtor, and the guarantors, shall be construed to release, waive, or impair the claim that U.S. Bank has against the original Northtown Partners, based upon the guaranties of said partners or applicable partnership law.

At the expense of debtors, separate and apart from the 4.3 million dollar loan, U.S. Bank will order a MAI appraisal of the "Athol" property and the residence of Lloyd Andrews.

Upon the default in the payment of any monthly payments provided for under the new loan, the payment of real estate taxes, personal property taxes, insurance, or compliance with the provision of obtaining take out

financing by the forty-ninth month of the term of the loan, or debtor's failure to provide additional collateral as may be required by U.S. Bank as provided hereafter, U.S. Bank upon thirty day written notice of default to the debtor, shall be entitled to the following relief:

- a. Immediate possession of the Bonner Mall property;
- b. Title, via previously executed deeds signed by the parties and held by counsel for U.S. Bank, to the Bonner Mall properties;
- c. All rental accounts and ongoing rental payments; and,
- d. A bankruptcy court order approving the conveyance of property to U.S. Bank free and clear of all liens.

The default rate upon the promissory note evidencing the new loan shall be the note rate plus eight percent. A late charge will be charged upon any payment not paid within ten days of its due date, in an amount equal to ten percent of the amount not paid.

The new loan shall be evidenced by U.S. Bank's standard loan documents. U.S. Bank will obtain appraisals on all collateral pledged for the loan as set out above. The selection of appraisers shall be made by U.S. Bank as required by FIRREA. The loan shall close before the appraisals are complete. Mr. Magnuson and Mr. Andrews will provide evidence to the Bank's satisfaction as to the values of the collateral pledged for the new loan. If after the appraisals are completed, the loan to value is more than 65%, the debtor, Mr. Magnuson and Mr.

Andrews agree to provide additional collateral to reduce the loan to value percentage to 65% or less.

Mr. Magnuson and Mr. Andrews will provide current personal financial statements which are satisfactory to U.S. Bank. In addition, Mr. Magnuson and Mr. Andrews will provide, on an annual basis, updated personal financial statements which are satisfactory to the Bank within ninety days of the calendar year-end. The debtor will provide monthly financial statements within fifteen days of each calendar month and an annual financial statement within ninety days of the calendar year-end for the mall which are satisfactory to the Bank.

Finally, at the closing of the loan, Mr. Magnuson and Mr. Andrews will pay a loan fee of \$43,000.00.

5.3.2 Class 2b: The holder of the Class 2b claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2b claim otherwise agree to alternative treatment of the claim, the Class 2b claim shall be satisfied in the manner described in Paragraph 5.3.2.1 below, or if First Security Bank, formerly First National Bank of North Idaho, properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2b claim shall be satisfied in the manner described in Paragraph 5.3.2.2 below.

5.3.2.1 The holder of the Class 2b claim, First Security Bank, formerly First National Bank of North Idaho (FSB), shall retain its lien securing its claim and shall receive monthly cash payments of \$5600 from the Reorganized Debtor or the guarantors, H.F. Magnuson and Lloyd

Andrews, commencing on the first monthly anniversary of the effective date of the Plan and continuing thereafter until its entire secured claim plus accrued interest is paid in full. Interest shall be calculated at the contract rate.

In the event debtor defaults on the monthly payments provided for under the Plan, upon 30 days written notice, FSB shall be entitled to exercise all of its state law remedies against the collateral and the guarantors.

5.3.2.2 If the holder of the Class 2b claim is entitled to and does timely make an election under § 1111(b) of the Bankruptcy Code, then First Security Bank shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the Reorganized Debtor in equal monthly installments over a period of time, not less than thirty (30) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payment shall commence on the Effective Date.

5.3.2.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of First Security Bank.

5.3.3 Class 2c: The holder of the Class 2c claim is impaired under this Plan. The Class 2c claim shall be paid the sum of \$7,000 within thirty days of the effective date, which shall constitute full payment of the secured claim of the Class 2c creditor. The Class 2c creditor will waive any deficiency, which would not in any event exceed \$800.

5.3.4 Class 2d: The holder of the Class 2d claim is impaired under this Plan.

5.3.4.1 Triangle Development Company, shall retain its lien securing its claim and shall receive the following payments:

The sum of \$205,000 in cash payable on or before February 20, 1994. A payment of \$45,000 together with interest at the rate of seven percent per annum from January 1, 1994, on or before June 30, 1994. A payment of \$5000, with no interest thereon, as compensation for the lack of payments and compensation for attorney fees and costs, on or before January 31, 1995. In exchange for the above payments and after the receipt of the \$205,000 payment, Triangle will subordinate its interest in the parcel debtor has by separate order, following notice and hearing, leased to Kentucky Fried Chicken.

In the event any of the above payments are not timely made, and after 10 days written notice of default, a deed in lieu of foreclosure, in proper form as approved by the bankruptcy court, will be delivered to Triangle.

5.3.5 Class 2e: The holder of the Class 2e claim is impaired under this Plan. Unless the Reorganized Debtor and the holder of the Class 2e claim otherwise agree to alternative treatment of the claim, the Class 2e claim shall be satisfied in the manner described in Paragraph 5.3.5.1 below, or if D. L. Evans Bank properly elects application of § 1111(b) of the Bankruptcy Code, then the Class 2e claim shall be satisfied in the manner described in Paragraph 5.3.5.2 below.

5.3.5.1 D. L. Evans Bank, the holder of the Secured Claim constituting the Class 2e claim, shall retain its lien securing its Secured Claim and shall receive monthly cash payments in an amount equal to \$3,851 until its Allowed Secured Claim together with interest accruing following the Effective Date is paid. The payments shall be made by the Reorganized Debtor and the first payment shall be made on the first monthly anniversary of the Effective Date. For the purposes of this Plan, the Allowed Secured Claim shall be deemed to equal the outstanding principal balance of the claim as of the Effective Date after giving effect to the post Petition Date payments, which is less than the fair market value of the collateral. Interest shall be calculated at the lesser of 7% per annum or the rate specified in the contract between the Debtor and D. L. Evans Bank, or at the rate set by the Bankruptcy Court at confirmation.

5.3.5.2 If the holder of the Class 2e claim is entitled to and does timely make an election under § 1111(b) of the Bankruptcy Code, then D. L. Evans Bank shall retain its lien and its entire Allowed Claim, without interest, shall be paid by the Reorganized Debtor in equal monthly installments over a period of time, not less than thirty (30) years in duration, which period shall be set by the Court at the hearing on confirmation so as to result in a valuation of the payments to be made by the Reorganized Debtor, on a present discounted basis, being equal to the holder's Secured Claim. The first payment shall commence on the Effective Date.

5.3.5.3 Pursuant to the provisions of § 1129(b) of the Bankruptcy Code, the Debtor requests that the Court confirm the Plan without the consent of D. L. Evans Bank.

5.4 Unsecured Claims:

5.4.1 Class 3a: Class 3a claims are impaired under this Plan. The holders of Class 3a claims shall be paid the entire amount of their unsecured claim without interest in cash on the first monthly anniversary of the effective date. The Debtor is unaware of any such unsecured claims at this time.

5.4.2 Class 3b: The class 3b claims are impaired under the Plan. The holders of the Class 3b claims, the partners and insiders of the Debtor, shall not receive any payment on their claims until such time as the U.S. Bank loan has been taken out by permanent financing and all the remaining claims have been paid in full.

ARTICLE VI TREATMENT OF DISPUTED CLAIMS AND INTERESTS

6. Except as provided in Paragraph 5.4.2 above, all Disputed Claims will be resolved prior to any distributions by the Reorganized Debtor. Equity Security Interests are not entitled to any distributions from the Reorganized Debtor under this Plan.

ARTICLE VII MEANS FOR EXECUTION OF THE PLAN

7. The Debtor, the Estate, and Reorganized Debtor shall each perform or shall have performed all the acts required of them below, (unless the Debtor, the Estate, and the Reorganized Debtor all shall agree to perform

such acts at an earlier time) on the Effective Date of the Plan.

7.1 All assets of the Estate shall be vested in the Reorganized Debtor in accordance with 11 U.S.C. § 1141 and the Reorganized Debtor shall be free to manage its affairs with no further Court intervention, including the lawful manner of selecting directors and officers.

7.2 The Debtor shall assume all responsibility for completing any capital improvements planned during the reorganization period.

7.3 Notwithstanding any provision to the contrary in this Plan, all rights, claims, and causes of action, whether equitable or legal, of the Debtor, the Estate, or the Reorganized Debtor against all persons arising under any provision of the Bankruptcy Code, under state or federal law for the recovery of avoidable fraudulent conveyances or other transfers or under any other State or Federal law, shall be vested in the Reorganized Debtor. During the pendency of the Reorganization Case, prior to or following Confirmation, the Debtor-in-Possession or the Reorganized Debtor may commence adversary proceedings against persons or entities to realize upon any such causes of action. Any settlements shall be subject to review by the Bankruptcy Court, after appropriate notice and hearing in accordance with the Bankruptcy Rules.

7.4 Any objection to a claim by a party in interest in the Reorganization Case must be filed on or before one hundred twenty (120) days following the Effective Date unless said time period is extended by the Bankruptcy

Court for cause shown; provided, however, that the foregoing limitation does not apply to any claims filed subsequent to Confirmation.

7.5 Pursuant to Section 347(b) of the Bankruptcy Code, ninety (90) days after any distribution by the Reorganized Debtor provided for herein, the Reorganized Debtor shall stop payment on any check remaining unpaid to a holder of an Allowed Claim and any funds shall be returned to the Reorganized Debtor. From and after the date the Reorganized Debtor stops payment on any distribution check pursuant to this 7.5, the holder of the claim on account of which such check was issued shall be entitled to receive no further distributions on account of his claim and such holder's Allowed Claim shall thereupon be deemed satisfied in full.

7.6 The deadline for submission of all claims entitled to priority pursuant to Sections 507(a)(1), (a)(2) and (b) of the Bankruptcy Code incurred prior to Confirmation, with the exception of fees and costs of Professional Persons shall be thirty (30) days following Confirmation. Failure to file a claim by this date shall conclusively bar the claimant from asserting his claim, which claim shall be forever discharged.

7.7 Any negotiable instrument held by the holder of an impaired Allowed Claim shall be deemed exchanged, canceled, or satisfied, as the case may be on the Effective Date.

7.8 The Reorganized Debtor shall timely make all payments required under this Plan.

ARTICLE VIII
EXECUTORY CONTRACTS AND UNEXPIRED LEASES

8 The treatment of executory contracts and unexpired leases is specified below.

8.1 All executory contracts and unexpired leases of the Debtor not heretofore assumed or rejected, shall be assumed by the Debtor on the Effective Date, except those executory contracts and unexpired leases listed in the "Schedule of Rejected Executory Contracts" which is attached hereto as Exhibit A. Any claim arising from the rejection of an executory contract is a Class 3a claim and, any entity holding a claim based upon the rejection of an executory contract or unexpired lease pursuant to this Article must file a Proof of Claim with the Bankruptcy Court within 30 days after Confirmation. The failure of any such entity to file a Proof of Claim within the specified time period will result in the disallowance of such claim.

8.2 With regard to those executory contracts and unexpired leases which are not listed on Exhibit A, on the Effective Date, or as soon thereafter as is practicable, the Reorganized Debtor shall (a) cure the arrearages, if any, in such amounts as may be determined by the Court at the hearing on Confirmation or thereafter and (b) assume said executory contracts. Any party to an executory contract or unexpired lease scheduled for assumption as provided in this paragraph 8.2 shall, within the same deadline and in the same manner established for objections to confirmation, file any claim for arrearages

required to be cured by Section 365(b)(1) of the Bankruptcy Code and any objections to the assumption. Failure to assert such arrearages or to file any objections shall constitute an agreement to the assumption and an acknowledgment that no defaults or claims exist under said contract which require a cure.

ARTICLE IX
**SATISFACTION OF INDEBTEDNESS AND
 DISCHARGE OF CLAIMS**

9. The distribution made to the various Classes of creditors as provided for in this Plan shall be in full and complete satisfaction of their Allowed Claims. Except as otherwise provided in the Plan or the Order of Confirmation, Confirmation shall operate, as a discharge of any and all debts and claims as defined in Section 101(4) of the Bankruptcy Code against the Debtor or the Estate that arose at any time prior to Confirmation. The discharge of the Debtor and the discharge of claims against the Debtor, whether asserted against the Debtor or the Reorganized Debtor, shall be effective as to each claim, regardless of whether or not (a) the claim was scheduled, (b) a proof of claim was filed, (c) the claim is an Allowed Claim, or (d) the holder thereof voted to accept the Plan. Provided however, that nothing in this Article shall in any way constitute any waiver or impairment of the claim of U.S. Bank to proceed against other debtors who may be liable on its original obligation.

ARTICLE X
MODIFICATIONS OF THE PLAN

10 Pursuant to the provisions of Section 1127 of the Bankruptcy Code and Bankruptcy Rule 3019, the Debtor reserves the right to modify or alter the provisions of the Plan at any time prior or subsequent to Confirmation.

ARTICLE XI
**RETENTION OF JURISDICTION BY THE
BANKRUPTCY COURT**

11 Notwithstanding Confirmation, until entry of a final decree, the Bankruptcy Court shall retain jurisdiction to ensure that the purposes and intent of the Plan are carried out. Without limiting the generality of the foregoing, the Court shall retain jurisdiction for the following purposes:

11.1 Fixing and allowing any claim as a cost and expense of the administration of the Reorganization Case;

11.2 Reexamining any claim that has been allowed;

11.3 Hearing and determining any objection to a claim or interest. The failure of the Debtor to object to, or to examine any claim or equity security interest for the purpose of voting, shall not be deemed to be a waiver of the Debtor's right to object to, or re-examine any claim or equity security interest in whole or in part;

11.4 Hearing and determining any action brought by the Debtor or the Estate seeking to avoid any transfer of an interest of the Debtor in property, or any obligation incurred by Debtor, that is avoidable pursuant to applicable law;

11.5 Hearing and determining all causes of action, controversies, disputes, or conflicts between or among the Debtor and any other party, including those that were pending prior to Confirmation;

11.6 Hearing and determining all questions and disputes regarding title to the property of the Debtor or the Estate;

11.7 Correcting any defect, curing any omission, or reconciling any inconsistency in the Plan or the Order of Confirmation as may be necessary to carry out the purpose and intent of the Plan;

11.8 Hearing and determining any action brought by the Debtor to protect the Debtor and the Estate from actions of creditors, equity security holders, or other parties in interest;

11.9 Issuing any order necessary to implement the Plan or Order of Confirmation, including, without limitation, such declaratory and injunctive orders as are appropriate to protect the Debtor, the Estate, and the Reorganized Debtor from actions of creditors, equity security holders, or other parties in interest;

11.10 Hearing and determining any dispute relating to the terms or implementation of the Plan or Order of Confirmation, or to the rights or obligations of any parties in interest with respect thereto;

11.11 The modification of the Plan after Confirmation pursuant to the Bankruptcy Rules and the Bankruptcy Code in accordance with Article X above; and

11.12 Entering orders concluding and terminating the Reorganization Case.

11.13 To enforce any provisions or agreements between the Debtor and creditors, particularly the Debtor and U.S. Bank, under the default provisions of such agreements as provided herein.

DATED this 9 day of March, 1994.

ELSAESSER, JARZABEK &
BUCHANAN, CHTD

/s/ Barbara Buchanan
Barbara Buchanan, Attorney
for Debtor-in-Possession

EXHIBIT "A"

SCHEDULE OF REJECTED EXECUTORY CONTRACTS
AND UNEXPIRED LEASES

<i>Non-Debtor Party</i>	<i>Nature of Agreement</i>
NONE	

Supreme Court, U.S.
FILED
MAR 15 1994

OFFICE OF THE CLERK

IN THE
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,

v.

BONNER MALL PARTNERSHIP,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

RESPONSE OF PETITIONER TO
MEMORANDUM OF RESPONDENT
SUGGESTING THAT THE CASE IS MOOT

Bradford Anderson*
Dale G. Higer
David B. Levant
**Counsel of Record*
STOEL RIVES BOLEY
JONES & GREY
3600 One Union Square
600 University Street
Seattle, WA 98101-3197
(206) 624-0900
Counsel for Petitioner

3 PP

U.S. Bancorp Mortgage Company ("U.S. Bancorp"), petitioner in the above-captioned case, responds to the Memorandum of Respondent Suggesting that the Case is Moot, filed on March 14, 1994 (the "Memorandum").

The question presented in this case is as follows:

Whether the new value exception to the absolute priority rule survived enactment of the Bankruptcy Reform Act of 1978, permitting the debtor in the Chapter 11 bankruptcy case to confirm a nonconsensual plan of reorganization that allows the debtor's equity holders to retain ownership of the reorganized debtor while paying objecting creditors less than the full amount of their claims.

The facts set forth in the Memorandum are accurately stated. U.S. Bancorp therefore agrees that the case is moot and that it should be dismissed.

In the event that the Court finds that the facts described render the case moot, U.S. Bancorp respectfully requests that the Court vacate the decree below. See United States v. Munsingerwear Corp., 340 U.S. 36, 39-41 (1950). Such relief would be appropriate to "eliminate [] a judgment, review of which was prevented through happenstance." Id. U.S.

Bancorp does not believe that dismissal pursuant to Rule 46 of
the Rules of the Supreme Court is appropriate.

Respectfully submitted,



BRADFORD ANDERSON
Attorneys for Petitioner
U.S. Bancorp Mortgage
Company

MARCH 15 1994

No. 93-714

Supreme Court, U.S.
FILED
MAR 16 1994

OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1993

◆—————
U.S. BANCORP MORTGAGE COMPANY.

Petitioner,

v.

◆—————
BONNER MALL PARTNERSHIP,

Respondent.

◆—————
**On Writ Of Certiorari To The
United States Court Of Appeals
For The Ninth Circuit**

◆—————
**RESPONDENT'S REPLY TO
RESPONSE OF PETITIONER**

◆—————
BARBARA BUCHANAN
JOHN FORD ELSAESSEN, JR.
Counsel of Record
ELSAESSER JARZABEK &
BUCHANAN, CHTD.
Third & Lake Street
P.O. Box 1049
Sandpoint, ID 83864
(208) 263-8517
Counsel for Respondent

H P P

Both Bonner Mall and U.S. Bancorp have agreed that this case has been rendered moot in light of the Bankruptcy Court's confirmation of a plan of reorganization that does not implicate the "new value" principle, the issue upon which this Court granted certiorari. U.S. Bancorp further requests that the Court vacate the decree below, citing this Court's decision in *United States v. Munsingwear Inc.*, 340 U.S. 36, 39-41 (1950). U.S. Bancorp's reliance on *Munsingwear*, however, is misplaced. In *Munsingwear*, the controversy before the Court had become moot due to a change in government regulations over which the parties had no control. The Court held that vacating the judgment below was proper because review of it "was prevented through happenstance". 340 U.S. at 40, 71 S.Ct. at 107. The Court reasoned that it would be an unfair hardship for the parties to be bound by a decision that was rendered unreviewable due to circumstances beyond their control. *Id.*

In this case, by contrast, U.S. Bancorp and Bonner Mall have resolved their differences consensually through the form of a settlement. The fact that this case has now been rendered moot results solely from the voluntary actions of all parties.

In *Karcher v. May*, 484 U.S. 72, 108 S.Ct. 388 (1987), this Court rejected a request to vacate a lower court decision when the case before the Court had been rendered moot because a losing party voluntarily abandoned its right to appeal. The Court noted that the "controversy did not become moot due to circumstances unattributable to any of the parties." 484 U.S. at 83, 108 S.Ct. at 395. Rather, the case became moot because the losing party

below decided not to pursue its rights. Because the fairness considerations espoused by the Court in *Munsingwear* were not implicated, the Court held the "the *Munsingwear* procedure is inapplicable to this case." *Id.*

In the context of consensual settlements, the Courts of Appeal consistently have held that the *Munsingwear* rule and the rationale underlying it do not apply. See, e.g., *Arthur v. Manch*, 12 F.3d 377 (2d Cir. 1993); *Manufacturers Hanover Trust Co. v. Yanakas*, 11 F.3d 381 (2d Cir. 1993); *Oklahoma Radio Assocs. v. F.D.I.C.*, 3 F.3d 1436, 1439 (10th Cir. 1993); *In re United States*, 927 F.2d 626 (D.C. Cir. 1991); *In re Memorial Hospital of Iowa County, Inc.*, 862 F.2d 1299 (7th Cir. 1988). As the District of Columbia Circuit held in *In re United States*, "[w]here the losing party chooses to settle rather than to pursue its appeal, review is not prevented by 'happenstance'" as was the case in *Munsingwear*. 927 F.2d at 628.

The policy underlying the circuit courts' reasoning is strong. Vacating a lower court opinion in the absence of any hardship to the parties would constitute a waste of judicial resources and serve no benefit. See *Oklahoma Radio Assocs.*, 3 F.3d at 1444; *Clark Equipment Co. v. Lift Parts Mfg. Co.*, 972 F.2d 817, 820 (7th Cir. 1992); see also *Isumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Co.*, 114 S.Ct. 425, 431 (1993) (per curiam) (Stevens, J., dissenting from dismissal of certiorari as improvidently granted). As the Seventh Circuit noted in *In re Memorial Hospital*:

The bankruptcy and district judges devoted many hours to this case and resolved it on the merits. Their decisions have persuasive force as

precedent that may save other judges and litigants time in future cases. Some of this force would remain as long as the court's opinion were available to read; it does not vanish on vacatur, although such an order clouds and diminishes the significance of the holding.

862 F.2d at 1302. In addition, permitting the parties to vacate a lower court opinion as part of a settlement could lead to substantial abuses, such as "allow[ing] a party with a deep pocket to eliminate an unreviewable precedent it dislikes simply by agreeing to a sufficiently lucrative settlement to obtain its adversary's cooperation in a motion to vacate." *Yanakas*, 11 F.3d at 384; *Oklahoma Radio Assocs.*, 3 F.3d at 1444.

For the reasons set forth herein and in the "Memorandum of Respondent Suggesting that the Case is Moot" the Respondent respectfully suggests that this Court should dismiss the case as moot, but should decline the U.S. Bankcorp's request to vacate the opinions below.

DATED this 16 day of March, 1994.

/s/ Barbara Buchanan
BARBARA BUCHANAN
Attorney for Respondent,
Bonner Mall Partnership

MAR 27 1994

IN THE
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,

v.
BONNER MALL PARTNERSHIP,
Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

**PETITIONER'S REPLY IN SUPPORT OF
REQUEST TO VACATE DECISION BELOW**

Bradford Anderson*
Dale G. Higer
David B. Levant
**Counsel of Record*
STOEL RIVES BOLEY
JONES & GREY
3600 One Union Square
600 University Street
Seattle, WA 98101-3197
(206) 624-0900
Counsel for Petitioner

6 pp

The issue before the Court is whether, if the Court dismisses this case as moot, the Court should exercise its discretion, in accordance with its usual practice, to vacate the decision below.

The central teaching of United States v. Munsingwear, Inc., 340 U.S. 36 (1950), is that vacatur should be used "to prevent a judgment, unreviewable because of mootness, from spawning any legal consequences." Id. at 41. Bonner ignores this principle and urges the Court to restrict its established practice in moot cases of reversing or vacating the judgment below, id. at 39, to only those circumstances in which review was prevented through "happenstance" over which the petitioner has no control. Bonner overstates the importance of the Court's reference to "happenstance" in the Munsingwear case. In that case it appears that the party seeking vacatur (the United States) was also the party responsible for the case becoming moot. See id. at 37. Nevertheless, nothing in the Munsingwear decision suggests that the United States' involvement in the events causing the case to become moot had

any effect on the decision whether to vacate the decision below.

Bonner also goes too far in proposing that vacatur be denied in all cases that are settled. The Court has broad power to vacate any order brought before it for review, "as may be just under the circumstances." 28 U.S.C. § 2106. The decision whether to vacate is thus a discretionary power to be exercised on a case-by-case basis.

U.S. Bancorp recognizes that vacatur may not be appropriate in all cases. For example, in Karcher v. May, 484 U.S. 72 (1987), the appellants affirmatively withdrew their appeal. Id. at 76. And in certain lower court cases, see, e.g., Manufacturers Hanover Trust Co. v. Yanakas, 11 F.3d 381 (2d Cir. 1993), a party with "deep pockets" may have attempted to use settlement as a device to vitiate an adverse precedent.

In this case, however, the petitioner has not stipulated to or moved for dismissal of the case. Rather, U.S. Bancorp has agreed with Bonner that recent events have eliminated for

the time being the need for the Court's review of the Ninth Circuit's decision in this case. This case thus resembles Munsingwear, not Karcher.

Nor is there any suggestion that the settlement in this case was calculated to vitiate the decision below. The settlement was the product of months of negotiations that commenced before the decision below was issued. The settlement was without regard to its possible effect on legal precedent and was in no way an attempt nullify an unfavorable precedent. This is demonstrated by the fact that the settlement was concluded after the Court granted certiorari.

The facts of this case particularly favor vacatur. The decision below appears to be infected with a clear and substantial error. In reaching its decision, the Ninth Circuit appears to have relied on its belief that U.S. Bancorp's reading of Section 1129(b) of the Bankruptcy Code would render the "on account of" phrase superfluous. See Pet. App. A40-41. The Court of Appeals failed to consider the possible meaning of the phrase advanced by U.S. Bancorp. See Brief of

Petitioner at 23-24. The Court need not reach the merits of this case to recognize that the Court of Appeals rendered its decision without this information.¹ Regardless of whether the simple meaning of the "on account of" phrase advanced by U.S. Bancorp is correct, the fact remains that the Court of Appeals was completely unaware of a possible meaning or purpose of the phrase when it decided this case.

In addition, despite the appearance of mootness at this time, it is entirely possible that survival of the new value exception will again become an issue between the parties. Confirmation of a plan does not constitute a final order ending the bankruptcy court's supervision of a case. If Bonner fails to fulfill its obligations under the Third Amended Plan of Reorganization—which runs for five years—the parties would be back in the position they were in before U.S. Bancorp consented to the plan. Because U.S. Bancorp has not consented to and will not give advance consent to any possible

¹ The meaning of the phrase was first raised by the Court of Appeals at oral argument, and therefore was not addressed in U.S. Bancorp's briefs below.

plan of reorganization, it is likely that the question on which the Court has granted review would arise again at that time. Accordingly, the Court should "clear[] the path for future relitigation of the issues between the parties," Munsingwear, 340 U.S. at 39, by vacating the judgment below.

Respectfully submitted,



BRADFORD ANDERSON
Attorneys for Petitioners
U.S. Bancorp Mortgage
Company

MARCH 17, 1994

(6)

Supreme Court, U.S.
FILED
FEB 24 1994
OFFICE OF THE CLERK

No. 93-714

In the Supreme Court of the United States

OCTOBER TERM, 1993

U.S. BANCORP MORTGAGE COMPANY, PETITIONER

v.

BONNER MALL PARTNERSHIP

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

PAUL BENDER
Deputy Solicitor General

RONALD J. MANN
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

A3 pp

QUESTION PRESENTED

Whether the Bankruptcy Code authorizes a judge to confirm a plan of reorganization that grants the equity owners of a failed debtor an exclusive opportunity to purchase an ownership interest in the reorganized business, but does not provide for full payment of objecting classes of unsecured claims.

(I)

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statutory provision involved	2
Statement	2
Summary of argument	7
Argument:	
The plan proposed by respondent does not satisfy the requirements of the Bankruptcy Code	9
I. Sections 362 and 1129 of the Bankruptcy Code provide <u>a comprehensive framework</u> for determining whether a proposed plan of reorganization is sufficient to justify continuation of an automatic stay preventing a creditor from taking control of its collateral upon default by a bankrupt debtor	9
II. The Bankruptcy Code does not authorize a judge to confirm a plan of reorganization that grants the equity owners of a failed debtor an exclusive opportunity to purchase ownership interests in the reorganized business if the plan does not provide for full payment of objecting classes of unsecured claims	13
A. The fair and equitable standard does not permit confirmation of a plan granting equity owners an ownership interest in the reorganized enterprise over the objection of a class of unpaid unsecured claims	15
B. At a minimum, the absolute priority rule does not permit confirmation of a plan that grants equity owners an exclusive right to acquire an ownership interest in the reorganized enterprise over the objection of a class of unpaid unsecured claims	25
Conclusion.....	30
Appendix	1a

(III)

TABLE OF AUTHORITIES

Cases:	Page
<i>Bjolmes Realty Trust, In re</i> , 134 B.R. 1000 (Bankr. D. Mass. 1991)	26
<i>Case v. Los Angeles Lumber Products Co.</i> , 308 U.S. 106 (1939)	12, 15-16, 17, 18, 21, 22
<i>Dewsnup v. Timm</i> , 112 S. Ct. 773 (1992)	4
<i>Louisville Trust Co. v. Louisville, N.A. & C. Ry.</i> , 174 U.S. 674 (1899)	17
<i>Marine Harbor Properties Inc. v. Manufacturers Trust Co.</i> , 317 U.S. 78 (1942)	17
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988)	14
<i>Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)</i> , 995 F.2d 1274 (5th Cir. 1991), withdrawn on reh'g, 995 F.2d 1284 (1992), cert. denied, 113 S. Ct. 72 (1992)	6
<i>Toibb v. Radloff</i> , 111 S. Ct. 2197 (1991)	2
<i>United Savings Association v. Timbers of Inwood Forest Associates</i> , 484 U.S. 365 (1988)	3, 10
 Statutes:	
Bankruptcy Act of 1898, ch. 541, 30 Stat. 544	6, 15
Act of June 7, 1934, ch. 424, 48 Stat. 911 (formerly codified as Bankruptcy Act § 77B, 11 U.S.C. 207 (1935))	15
§ 77B, 48 Stat. 918-919	12, 15, 16, 17
§ 77B(e)(1), 48 Stat. 918	16
§ 77B(f)(1), 48 Stat. 919	15
Act of June 22, 1938 (Chandler Act), ch. 575, 52 Stat. 883 (formerly codified as Bankruptcy Act Chapter X, 11 U.S.C. 501-676 (1976))	15, 16, 17, 18
§ 179, 11 U.S.C. 579 (1976)	16
§ 221, 11 U.S.C. 621 (1976)	15
§ 221(2), 11 U.S.C. 621(2) (1976)	15, 16
 Bankruptcy Code, 11 U.S.C. 101 <i>et seq.</i>	
Ch. 1, 11 U.S.C. 101 <i>et seq.</i> :	
11 U.S.C. 102(3)	11

Statutes—Continued:	Page
Ch. 3, 11 U.S.C. 301 <i>et seq.</i> :	—
11 U.S.C. 362(a)	2-3, 9
11 U.S.C. 362(d)	10
11 U.S.C. 362(d)(2)	3
Ch. 5, 11 U.S.C. 501 <i>et seq.</i> :	—
11 U.S.C. 506	4
11 U.S.C. 506(a)	4
Ch. 11, 11 U.S.C. 1101 <i>et seq.</i>	2, 7, 8, 9, 10, 19, 20, 23, 24, 25
11 U.S.C. 1111(b)	4
11 U.S.C. 1121(b)	29
11 U.S.C. 1124	10, 14
11 U.S.C. 1126(e)	11, 16
11 U.S.C. 1129	2, 7, 10, 15, 19, 28, 29, 30, 1a
11 U.S.C. 1129(a)	10, 1a
11 U.S.C. 1129(a)(8)	10, 2a
11 U.S.C. 1129(a)(11)	22, 3a
11 U.S.C. 1129(b)	9, 10, 11, 13, 16, 25, 4a
11 U.S.C. 1129(b)(1)	8, 11, 12, 13, 19, 20, 25, 29, 4a
11 U.S.C. 1129(b)(2)	11, 25, 4a
11 U.S.C. 1129(b)(2)(A)	11, 12, 4a
11 U.S.C. 1129(b)(2)(B)	11, 12, 18, 5a
11 U.S.C. 1129(b)(2)(B)(i)	12, 14, 22, 5a
11 U.S.C. 1129(b)(2)(B)(ii)	7, 9, 12, 13, 22, 26, 27, 28, 5a
 Miscellaneous:	
Barry E. Adler, <i>Bankruptcy and Risk Allocation</i> , 77 Cornell L. Rev. 439 (1992)	23
John D. Ayer, <i>Rethinking Absolute Priority After Ahlers</i> , 87 Mich. L. Rev. 963 (1989)	17, 19
Douglas G. Baird, <i>The Uneasy Case for Corporate Reorganizations</i> , 15 J. Legal Stud. 127 (1986)	23
Lucian A. Bebchuk, <i>A New Approach to Corporate Reorganizations</i> , 101 Harv. L. Rev. 775 (1988)	23
Black's Law Dictionary (5th ed. 1978)	27
Walter J. Blum and Stanley A. Kaplan, <i>The Absolute Priority Doctrine in Corporate Reorganizations</i> , 41 U. Chi. L. Rev. 651 (1974)	20-21

Miscellaneous—Continued:	Page
Michael Bradley and Michael Rosenzweig, <i>The Untenable Case for Chapter 11</i> , 101 Yale L.J. 1043 (1992)	23, 24
Collier on Bankruptcy (James Wm. Moore 14th ed. 1940, Lawrence P. King rev. 1977)	12, 15, 16
124 Cong. Rec. (1978):	
p. 32,407	19
p. 34,006	19
Peter F. Coogan, <i>Confirmation of a Plan Under the Bankruptcy Code</i> , 32 Case W. Res. L. Rev. 301 (1982) ..	15
H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977)	11, 12, 13, 20
Thomas H. Jackson and Robert E. Scott, <i>On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditor's Bargain</i> , 75 Va. L. Rev. 155 (1989)	23
Jerome R. Kerkman, <i>The Debtor in Full Control: A Case for Adoption of the Trustee System</i> , 70 Marq. L. Rev. 159 (1987)	25
Lynn M. LoPucki, <i>Strategies for Creditors in Bankruptcy Proceedings</i> (2d ed. 1991)	4, 27
Lynn M. LoPucki, <i>The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?</i> (Pt. 2), 57 Am. Bankr. L.J. 247 (1983)	24, 29
Lynn M. LoPucki, <i>The Trouble with Chapter 11</i> , 1993 Wis. L. Rev. 729	24
Lynn M. LoPucki and William C. Whitford, <i>Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies</i> , 139 U. Pa. L. Rev. 125 (1990)	25
Lynn M. LoPucki and William C. Whitford, <i>Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies</i> , 1991 Wis. L. Rev. 11	29, 30
Robert K. Rasmussen, <i>Debtor's Choice: A Menu Approach to Corporate Bankruptcy</i> , 71 Texas L. Rev. 51 (1992) ..	23
Report of the Commission on the Bankruptcy Laws of the United States, Pt. 2, H.R. Doc. No. 137, 93d Cong., 1st Sess. (1973)	18
David A. Skeel, Jr., <i>Markets, Courts and the Brave New World of Bankruptcy Theory</i> , 1993 Wis. L. Rev. 465	24

Miscellaneous—Continued:	Page
Elizabeth Warren, <i>A Theory of Absolute Priority</i> , 1991 Ann. Survey Amer. Law 9	27, 28

In the Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-714

U.S. BANCORP MORTGAGE COMPANY, PETITIONER

v.

BONNER MALL PARTNERSHIP

*ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT*

**BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER**

INTEREST OF THE UNITED STATES

This case presents the question whether the Bankruptcy Code authorizes a judge to confirm a plan of reorganization that grants the equity owners of a failed debtor an exclusive opportunity to purchase an ownership interest in the reorganized business, but does not provide for full payment of objecting classes of unsecured claims. That question is of great interest to the United States because various agencies of the federal government—including the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the Small Business Administration, the Farmers Home Administration, and the Rural Electrification Administration—frequently participate as creditors in bankruptcy reorganization proceedings,

and because the Court's resolution of that question significantly will affect the ability of creditors to gain control of businesses that seek to reorganize under the Bankruptcy Code without repaying their creditors.

STATUTORY PROVISION INVOLVED

Section 1129 of the Bankruptcy Code, 11 U.S.C. 1129, is set forth in an appendix, *infra*, 1a-6a.

STATEMENT

1. In 1984 and 1985, an entity named Northtown Investments built the Bonner Mall in Bonner County, Idaho. Northtown financed construction of the mall with a \$6.3 million loan from First National Bank of North Idaho; petitioner now holds that loan. In October of 1986, Northtown sold the mall to respondent, subject to the mortgage that secures repayment of petitioner's loan. Respondent is an investment vehicle formed for the purpose of buying the mall; it is composed of five trusts and an individual investor. When income from the mall declined, respondent defaulted in the payment of real property taxes owed to Bonner County, Idaho. Petitioner then exercised its right under the loan documents to schedule the property for a foreclosure sale to be held on March 14, 1991. See Pet. App. A4-A5, A91-A92.

2. On the day before the sale, respondent filed a petition in the United States Bankruptcy Court for the District of Idaho, seeking relief under Chapter 11 of the Bankruptcy Code.¹ Under Section 362(a) of the

Code, 11 U.S.C. 362(a),² the filing of the bankruptcy petition automatically stayed petitioner's foreclosure sale. Petitioner accordingly sought relief from the stay. Because the amount due to petitioner (about \$6.6 million) exceeded the value of the mall, petitioner was entitled under the Code to proceed to foreclosure unless respondent could establish that retention of the mall was necessary to an effective reorganization and that there was a reasonable possibility of a successful reorganization within a reasonable time. Section 362(d)(2); see *United Savings Association v. Timbers of Inwood Forest Associates*, 484 U.S. 365, 374-376 (1988); Pet. App. A5-A7, A19, A92-A93.

a. On August 23, 1991, the bankruptcy court issued an opinion denying petitioner's motion for relief from the stay. Pet. App. A118-A129. The court accepted respondent's argument that there was a realistic prospect for reorganization, based on respondent's intention to contribute additional capital, in return for which it was contemplated that respondent would retain an ownership interest in the reorganized enterprise. *Id.* at A124-A125. Because the court concluded that it could not rule out the possibility of an effective reorganization, the court denied the motion for relief from the stay. *Id.* at A127.

b. Respondent filed its First Amended Plan of Reorganization on October 31, 1991. See Pet. App. A93. That plan provides for transfer of respondent's assets to a new entity, Bonner Mall Properties, Inc. (BMP). J.A. 6. Three aspects of the plan are important for this case. First, BMP would pay petitioner's

¹ Chapter 11 generally provides for the reorganization of business enterprises. See *Toibb v. Radloff*, 111 S. Ct. 2197, 2199-2202 (1991) (discussing the scope of Chapter 11).

² For convenience, we cite the provisions of Title 11 by Section number only; similarly, we refer to the entire Title as the Code.

secured claim (\$3.2 million)³ in a single balloon payment 32 months after confirmation, with monthly interest payments to be made during the interim.⁴ J.A. 11.⁵ Second, the general unsecured claims (petitioner's deficiency of about \$3.4 million,⁶ as well as the claims of other miscellaneous creditors) would be discharged in exchange for shares of stock in BMP at a rate of under ten cents on the dollar; all of those claims would be satisfied by the issuance of 300,000 shares of preferred stock with a par value of \$1 each. Those preferred shares could be redeemed at any time by BMP for their par value, but could be converted by petitioner, if respondent succeeded in repaying petitioner's secured claim, to 15% of the then outstanding common stock of BMP. J.A. 19-20. In return for a contribution of \$200,000, and an obligation to fund any shortfall in working capital until the

³ In its August 1991 opinion, the court concluded that the mall was worth only \$3.2 million, relying on local tax assessment figures. Pet. App. A125-A126.

⁴ Alternatively, if petitioner elected that its entire claim be treated as secured under Section 1111(b), petitioner would be repaid in equal monthly installments over 30 years in an amount that would have a discounted present value equal to petitioner's secured claim. J.A. 14. For a general discussion of the reasons a creditor would make a Section 1111(b) election, see Lynn M. LoPucki, *Strategies for Creditors in Bankruptcy Proceedings* § 12.9.4 (2d ed. 1991) [hereinafter LoPucki, *Strategies*].

⁵ The holders of the other secured claims also were to be repaid by various schedules of monthly or annual payments specified in the plan. J.A. 13-17.

⁶ Under Section 506(a), the portion of petitioner's claim that exceeds the value of the collateral is treated as an unsecured claim. See generally *Dewsnup v. Timm*, 112 S. Ct. 773 (1992) (discussing the effect of Section 506 on undersecured creditors).

maturity date of petitioner's claim, respondent's owners would receive 2 million shares of common stock. J.A. 19. See generally Pet. App. A19-A22, A93-A95 (summarizing terms of the plan).

To put the matter in practical terms, if BMP did not succeed in paying off petitioner's secured claim, petitioner would be able to take control of the mall at the end of the 32 months,⁷ in which event the ownership interests (including the preferred stock representing petitioner's unsecured claim) would have negligible value. If BMP did succeed, petitioner's secured claim would be repaid, and the preferred stock representing petitioner's \$3.4 million unsecured claim could either (a) be redeemed for \$300,000 (if BMP desired to do so) or (b) be exchanged for 15% of the ownership in BMP (if BMP did not redeem the stock before petitioner decided to exchange it for common stock).⁸ If petitioner's preferred stock were converted to common stock, respondent's owners would hold about 85% of the ownership as compensation for their contribution of \$200,000; if petitioner's preferred stock were redeemed, the contribution of respondent's owners would bring 100% of the ownership interests.

⁷ See J.A. 11-12 (discussing petitioner's remedies if respondent fails to comply with the plan).

⁸ The actual amounts would be about 93% of the \$300,000 and 15% figures stated in the plan, because those entitlements were to be shared pro rata among all of the general unsecured claimants (classified under the plan as Class 3a unsecured claims). J.A. 19-20. Petitioner's \$3.4 million claim constitutes about 93% of the \$3,644 million in Class 3a unsecured claims. See First Amended Disclosure Statement (Oct. 31, 1991), Record on Appeal item 15, at 18 & n.4 (included in the excerpts of record filed by petitioner in the court of appeals).

c. After consideration of the proposed plan, the bankruptcy judge issued an opinion on December 6, 1991, granting petitioner's motion for relief from the stay, based on the court's conclusion that the Bankruptcy Code does not permit the owners of a failed enterprise to retain an ownership share in the reorganized business over the objection of unpaid creditors, even if the ownership share rests on "new value" contributed by the owners. J.A. 29-33. The court relied on the opinion issued by a panel of the Fifth Circuit in *Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, 995 F.2d 1274 (1991), which set forth a similar interpretation of the Code.⁹ J.A. 31-32.

3. The district court reversed. Pet. App. A90-A117.¹⁰ The court concluded "that the new value exception to the absolute priority [rule] did survive the enactment of the 1978 Bankruptcy Code." *Id.* at A116.

4. The court of appeals affirmed. Pet. App. A1-A84. The court first concluded (*id.* at A33-A51) that the precise terms of the Code did not eliminate the rule, developed in cases under the old Bankruptcy Act, that permitted owners to participate in reorganizations if they contributed new value to the reorganized entity (a rule generally referred to as the "new value exception"). The court acknowledged that the Code bars owners from receiving an interest under a plan of reorganization "on account of" their prior interest

⁹ The *Greystone* panel's opinion subsequently was withdrawn on rehearing. 995 F.2d 1284 (per curiam), cert. denied, 113 S. Ct. 72 (1992).

¹⁰ A slight correction was made by an opinion reprinted at Pet. App. A88-A89.

in the failed business. The court reasoned, however, that a plan giving the prior owners an interest is permissible—even if they have an exclusive right to acquire that ownership interest—because their participation is permitted not "on account of" their prior interest in the debtor but "because such participation is necessary for a successful reorganization and in the best interests of all concerned." *Id.* at A50.

The court also rejected (Pet. App. A61-A71) petitioner's argument that the dramatic changes in reorganization practice introduced by the Code had abolished the new value exception. The court concluded that "the structural changes to the reorganization process made by the Code are in harmony with the pro-confirmation principle underlying the new value exception." *Id.* at A64.

Finally, the court stated (Pet. App. A71-A79) that the new value exception is consistent with the underlying policies of Chapter 11 because it encourages "successful rehabilitation of debtors," and "maximize[s] the value of the estate." *Id.* at A71-A72. The court rejected petitioner's argument that the new value exception conflicts with the Chapter 11 policy of protecting creditor interests because "successful debtor reorganization and maximization of the value of the estate are the primary purposes [of Chapter 11]." *Id.* at A74-A75.

SUMMARY OF ARGUMENT

Section 1129 of the Code bars confirmation of a plan of reorganization in a Chapter 11 proceeding over the objection of a class of unpaid unsecured claims if the plan grants the owners of the failed business "any property" "on account of" their ownership of the failed business, Section 1129(b)(2)(B)(ii), and permits

confirmation only if the plan is otherwise "fair and equitable," Section 1129(b)(1). The plan proposed in this case fails both of those standards.

1. The statutes that preceded the Code permitted confirmation of a plan only if it was both fair and equitable and also approved by the creditors. In cases interpreting those statutes, this Court suggested that a plan could be fair and equitable even if the owners retained an interest in the reorganized business without repaying all of the creditors, but only if that interest were given in return for a contribution of new value by the owners. Because those statutes did not permit confirmation of any plan without creditor consent, the new value rule recognized by the Court did not permit the owners of the failed business to retain an interest without consent of the creditors as a group.

The Code adopts a different framework for approving reorganizations, under which a plan can be confirmed if it is either fair and equitable or approved by the creditors. In our view, that framework is designed to allow creditors to determine when continuing participation in ownership by the owners of the failed business would aid the success of the reorganized enterprise. Because the creditors are the parties with money at stake, the Court should be reluctant to read the Code to permit judges to second-guess the creditors' judgment regarding how best to reorganize the business. Furthermore, offering the owners an opportunity to insist on a share of the reorganized business without repaying their creditors would tend to exacerbate the problems that have made Chapter 11 proceedings both expensive and protracted. These considerations indicate that a plan allowing owners to retain an interest over the

objection of a class of unpaid unsecured claims is not "fair and equitable" within the meaning of the Code and thus cannot be confirmed under Section 1129(b).

2. The Court can decide this case without reaching the broad question whether the Code permits any plan providing for continued participation without repaying objecting creditors, because the plan proposed in this case is objectionable on a narrower ground as well. The plan would grant respondent's owners the exclusive right to purchase a controlling interest in the reorganized business; that exclusive right constitutes "property" that would be conferred by the plan. Because the only plausible basis for granting that right would be the status of its recipients as former owners of the business, the grant would be one made "on account of" the interest those individuals held in the failed business. Accordingly, it is barred by the language of Section 1129(b)(2)(B)(ii).

ARGUMENT

THE PLAN PROPOSED BY RESPONDENT DOES NOT SATISFY THE REQUIREMENTS OF THE BANKRUPTCY CODE

I. Sections 362 And 1129 Of The Bankruptcy Code Provide A Comprehensive Framework For Determining Whether A Proposed Plan Of Reorganization Is Sufficient To Justify Continuation Of An Automatic Stay Preventing A Creditor From Taking Control Of Its Collateral Upon Default By A Bankrupt Debtor

This case comes to the Court on appeal from petitioner's motion for relief from the automatic stay imposed by Section 362(a) of the Code. Petitioner seeks relief from the stay so that it can foreclose the mortgage it holds on the mall respondent owns.

Under Section 362(d), petitioner is entitled to relief from the stay if respondent “does not have an equity in [the] property” and if the “property is not necessary to an effective reorganization.” Because it is clear that respondent does not have an equity in the property—petitioner’s claim of about \$6.6 million far exceeds the value of \$3.2 million determined by the bankruptcy court—the remaining question is whether the property is necessary to an effective reorganization. See generally *United Savings Association v. Timbers of Inwood Forest Associates*, 484 U.S. 365, 374-376 (1988) (discussing Section 362(d)). As the case now stands, the only possible basis for an effective reorganization is the plan considered by the court of appeals. Hence, petitioner is entitled to relief from the stay if the Code prohibits confirmation of that plan.

Section 1129 of the Code sets forth the exclusive circumstances under which a judge can confirm a plan of reorganization in a Chapter 11 proceeding.¹¹ The thirteen paragraphs of Section 1129(a) impose specific requirements for confirmation, including, of particular relevance here, the requirement in paragraph (8) that each impaired class of claims must accept the plan.¹² Section 1129(b), however, allows a judge in

¹¹ The first clause of Section 1129(a) states that “[t]he court shall confirm a plan only if all of the following requirements are met” (emphasis added).

¹² Section 1124 of the Code defines impairment. It is undisputed that the proposed plan would impair the classes of claims that include petitioner’s secured and unsecured claims. See J.A. 11, 17. It also is undisputed that petitioner would oppose the plan. See Pet. App. A23 (“It is a foregone conclusion that * * * the unsecured class of which [petitioner] is the principal member will vote not to confirm the plan.”). Because

certain circumstances to confirm a plan even if an impaired class of claims does not consent, but only if “the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan,” Section 1129(b)(1). The common references to “cramdowns” in reorganization proceedings refer to a judge’s approval of a plan under Section 1129(b) without the consent of all of the impaired classes of claims.¹³

Paragraph (2) of 1129(b) sets forth the minimum content for the meaning of the “fair and equitable” requirement, by stating that “the condition that a plan be fair and equitable with respect to a class includes the following requirements.”¹⁴ Those requirements are grouped into three subparagraphs:, subparagraph (A) dealing with secured claims, subparagraph (B) dealing with unsecured claims, and subparagraph (C) dealing with interests. Subparagraph (B) is the provision relevant to this case, which involves the fairness of the plan’s treatment of

petitioner holds about 93% of the claims in that class, see note 8, *supra*, its vote would be sufficient to prevent acceptance of the plan by that class under Section 1126(c); that Section requires an affirmative vote of “at least two-thirds in amount and more than one-half in number of the allowed claims of [the] class.”

¹³ See, e.g., H.R. Rep. No. 595, 95th Cong., 1st Sess. 413 (1977) [hereinafter House Report] (noting that Section 1129(b) “contains the so-called cramdown”).

¹⁴ The provisions of the Code establishing rules of construction make it clear that the specific references in Section 1129(b)(2) to what the “fair and equitable” standard “includes” are not exclusive. See Section 102(3) (“[I]ncludes’ and ‘including’ are not limiting.”).

petitioner's unsecured claim.¹⁵ Subparagraph (B) requires a plan, at a minimum, to meet one of two options in order to satisfy the "fair and equitable" standard of Section 1129(b)(1). First, the plan can pay the claim in full as of the date of the plan. Section 1129(b)(2)(B)(i). If the plan does not pay the claim in full, however, it must comply with the so-called "absolute priority" rule,¹⁶ which states: "[T]he holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."¹⁷ Section 1129(b)(2)(B)(ii). In addition, as

¹⁵ The proposed plan would satisfy the requirements of Section 1129(b)(2)(A) with respect to petitioner's secured claim by providing for payments with a present value as of the date of the plan equal to the entire value of petitioner's secured claim. See J.A. 11-12.

¹⁶ The term "absolute priority" apparently was adopted to distinguish the rule from a system of "relative priority," which would allow interests with claims of lower priority to share in the estate, provided they received less than claims of higher priority. See *Collier on Bankruptcy* ¶ 11.06, at 221 (James Wm. Moore 14th ed. 1940, Lawrence P. King rev. 1977) [hereinafter *Collier's* 14th ed.]; see also *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 119 (1939) (holding that a plan violated the absolute priority rule of Section 77B of the Bankruptcy Act even though "the relative priorities of the bondholders and the old * * * stockholders are maintained").

¹⁷ The House Report explained the purpose of the provision as follows:

It requires simply that the plan meet certain standards of fairness to dissenting creditors or equity security holders. The general principle of the subsection permits confirmation notwithstanding nonacceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. The dissenting class must be

noted above, even if a plan meets one of subparagraph (B)'s two options, it also must satisfy the general "fair and equitable" standard of Section 1129(b)(1).

Respondent's plan proposes that its owners, whose interests are junior to petitioner's, receive an ownership interest in the reorganized debtor in return for a capital contribution of \$200,000 and an obligation to fund working capital shortfalls during the first 32 months of the plan. J.A. 19. That plan violates Section 1129(b) if it fails the general "fair and equitable" standard established by Section 1129(b)(1), or if it gives those junior claimants any "property" "on account of" their prior ownership interest, Section 1129(b)(2)(B)(ii). For the reasons set forth below, we submit that the proposal does not comport with either of those standards.

II. The Bankruptcy Code Does Not Authorize A Judge To Confirm A Plan Of Reorganization That Grants The Equity Owners Of A Failed Debtor An Exclusive Opportunity To Purchase Ownership Interests In The Reorganized Business If The Plan Does Not Provide For Full Payment Of Objecting Classes Of Unsecured Claims

This is not the first time that the Court has considered the permissibility under the Code of a plan of reorganization that would force creditors to accept a plan under which the equity owners of a failed

paid in full before any junior class may share under the plan. If it is paid in full, then junior classes may share.

House Report, *supra* note 13, at 413; see *ibid.* ("[I]f the class is impaired, then they must be paid in full or, if paid less than in full, then no class junior may receive anything under the plan.").

debtor would retain an ownership interest in a reorganized debtor. The Court previously considered that question in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), where the Court determined that the plan proposed in that case violated the Code because the consideration offered by the owners for the interest in the reorganized debtor was not sufficiently concrete. *Id.* at 202-209. We argued in that case that the language and structure of the Code prohibit in all circumstances confirmation of a plan that grants the prior owners an equity interest in the reorganized debtor over the objection of a class of unpaid unsecured claims.¹⁸ See Brief for the United States as Amicus Curiae at 11-23, *Ahlers* (No. 86-958, O.T. 1987) [Ahlers Brief]¹⁹; *Ahlers*, 485 U.S. at 203-204 n.4 (noting the government's argument). As explained below, we continue to hold the views we expressed in *Ahlers*. See Point II.A, *infra*. But even if there are some circumstances in which the Code would permit confirmation of such a plan, this case does not present them, because the plan proposed in this case would grant the prior owners an exclusive opportunity to acquire an ownership interest in the reorganized debtor. See Point II.B, *infra*.

¹⁸ We refer to a class of unpaid unsecured claims as a convenient term to describe a class of claims that is both impaired (under Section 1124), and not paid in full (under Section 1129(b)(2)(B)(i)).

¹⁹ We have provided copies of the *Ahlers* Brief to all counsel who participated in this case at the petition stage.

A. The fair and equitable standard does not permit confirmation of a plan granting equity owners an ownership interest in the reorganized enterprise over the objection of a class of unpaid unsecured claims

1. The Congress that enacted the Code in 1978 did not write on a clean slate in drafting the framework for approving plans of reorganization that appears in Section 1129. Both the Chandler Act of 1938 (codified as Chapter X of the old Bankruptcy Act of 1898)²⁰ and Section 77B (its 1934 precursor)²¹ included procedures for adopting plans for the reorganization of failing businesses. Three features of those predecessor statutes are important for understanding the legal landscape that confronted the drafters of the Code. First, the prior statutes authorized a court to approve a plan only if it was "fair and equitable"; thus, those statutes did not permit adoption of a plan that did not meet the "fair and equitable" standard, even if the creditors voted to approve the plan.²² Second,

²⁰ The Chandler Act of 1938, ch. 575, 52 Stat. 883, added a new Chapter X to the Bankruptcy Act. Under Section 221 of that Chapter, a court could confirm a plan only if it found, among other things, that "the plan is fair and equitable." 11 U.S.C. 621(2) (1976). See generally *Collier's 14th ed.*, *supra* note 16, ¶ 11.06 (discussing "fair and equitable" requirement of Chapter X of the Bankruptcy Act).

²¹ Section 77B was added to the 1898 Act by the Act of June 7, 1934, ch. 424, 48 Stat. 911. Under Section 77B(f)(1), a judge could confirm a plan only if it found that the plan was "fair and equitable and d[id] not discriminate unfairly in favor of any class of creditors or stockholders." 48 Stat. 919.

²² See Peter F. Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 Case W. Res. L. Rev. 301, 325-326 (1982) (discussing pre-Code law requiring both approval by creditors and a finding that plan was fair and equitable); see also *Case v.*

neither of those statutes offered any definition of the “fair and equitable” standard.²³ Third, each of those statutes required creditor consent for adoption of a plan in all cases.²⁴

In the absence of a statutory definition, this Court concluded that “[t]he words ‘fair and equitable’ as used in § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations.” *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 115 (1939). In Justice Douglas’s words, that phrase was intended to codify “the ‘familiar rule’ * * * that ‘any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of either class of

Los Angeles Lumber Products Co., 308 U.S. 106, 115 (1939) (denying confirmation of a Section 77B plan as not fair and equitable even though creditors had approved the plan; explaining that “the fact that [an overwhelming majority of the creditors] have approved the plan is * * * immaterial on the basic issue of its fairness”).

²³ 11 U.S.C. 621(2) (1976); 48 Stat. 919 (Bankruptcy Act § 77B(f)(1)). See generally *Collier’s 14th ed., supra* note 16, ¶11.06 (discussing “fair and equitable” requirement of Chapter X of the Bankruptcy Act); *id.* ¶ 11.04, at 181 & n.1 (noting that the relevant provision of Chapter X was “derived from former §77B(f)(1)” and that “[t]here has been no change in substance”).

²⁴ Section 77B(e)(1), 48 Stat. 918 (requiring acceptance of plan by two-thirds in amount of the claims of each class); Chapter X § 179, 11 U.S.C. 579 (1976) (requiring acceptance by two-thirds in amount of the claims of each class); cf. Section 1126(c) (current provision, which requires acceptance by at least two-thirds in amount and more than one-half in number of the claims of each class, but which need not be satisfied if plan is crammed down under Section 1129(b)).

creditors comes within judicial denunciation.” *Id.* at 116 (quoting *Louisville Trust Co. v. Louisville, N.A. & C. Ry.*, 174 U.S. 674, 684 (1899)).²⁵ Because the plan before the Court did not satisfy that standard—old equity owners received property under the plan, even though creditors were not repaid in full—the Court rejected the plan. 308 U.S. at 122-132 (analyzing plan).²⁶

In the course of elucidating the meaning of the “familiar rule” that the *Case* Court discerned in the “fair and equitable” requirement of Section 77B, Justice Douglas stated in dictum that “there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor,” which he described as arising out of “the necessity, at times, of seeking new money essential to the success of the undertaking from the old stockholders.” 308 U.S. at 121. Even in those circumstances (which would have included, under the applicable statutory scheme, consent by a requisite majority of the affected classes of claims), the Court explained that the opportunity for participation by the old stockholders should be strictly limited. The Court explained:

[W]e believe that to accord the creditor his full right of priority against the corporate assets

²⁵ As at least one commentator has noted, the accuracy of Justice Douglas’s analysis of the prior cases is questionable. See John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963, 974-975 (1989).

²⁶ Three years later, in *Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, 317 U.S. 78, 85 (1942), the Court applied its analysis of the “fair and equitable” standard in Section 77B to cases arising under Chapter X of the Bankruptcy Act.

where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

Id. at 122 (internal quotation marks omitted).

2. When Congress enacted the Bankruptcy Code in 1978, it dramatically restructured the framework for business reorganizations, in a way that removes any need or basis for the new value rule articulated by Justice Douglas in *Case*. Most importantly, the Code—unlike Chapter X of the Act—includes a detailed definition of the “fair and equitable” standard, which for the most part codifies the absolute priority rule that was the basis for the holding in *Case*. As described above, Section 1129(b)(2)(B) proscribes plans that allow the old equity owners to receive “any property” under the plan “on account of” their ownership interest in the debtor. Nothing in that definition mirrors the new value rule articulated in *dictum* in *Case*, and thus nothing in the statute specifically authorizes a judge to confirm a plan permitting old equity owners to participate over the objection of a class of unpaid unsecured claims.²⁷

²⁷ Congress's treatment of the subject was not inadvertent. The 1973 Report of the Bankruptcy Commission, on which the Code was based, recommended that Congress include a provision that would have authorized the judge to allow old equity owners to retain an interest under a plan whenever the judge determined that the owners would “make a contribution which is important to the operation of the reorganized debtor.” Report of the Commission on the Bankruptcy Laws of the United States, Pt. 2, H.R. Doc. No. 137, 93d Cong., 1st Sess. 242 (1973) (proposed Section 7-303(4)). As the Commission explained in the accompanying note, its intent was that “the

Furthermore, in a significant departure from the Code's predecessors, the Code allows a plan to be confirmed even if it does not meet the fair and equitable standard, if the creditors consent.²⁸ The Code's reliance on creditor consent limits the scope of concerns courts need to address under the malleable “fair and equitable” requirement. Under Chapter 11 of the Code, creditors are permitted to determine if their best interests will be served by a plan that permits participation by the old equity holders even if the creditors' claims are not repaid in full, and if the creditors—voting in classes—agree to the plan, the bankruptcy judge can confirm it, even if it does not satisfy the “fair and equitable” standard of Section 1129(b)(1).

Creditors might agree to such a plan for any number of reasons. Most obviously, one or more of the old equity owners might have a special expertise

absolute priority rule * * * [be] made more flexible.” *Id.* at 254. After the Commission's proposal on that point was criticized heavily, Congress abandoned it in favor of the scheme that appears in Section 1129. See *Ayer, supra* note 25, at 978-979.

²⁸ Congress recognized the importance of that change. As Senator DeConcini and Representative Edwards explained in their detailed comments to their respective Chambers regarding the final version of the bill that became the Code:

It must be emphasized that the fair and equitable requirement applies only with respect to dissenting classes. Therefore, unlike the fair and equitable rule contained in chapter X and section 77 of the Bankruptcy Act under section 1129(b)(2), senior accepting classes are permitted to give up value to junior classes as long as no dissenting intervening class receives less than the amount of its claims in full.

124 Cong. Rec. 32,407 (comments of Representative Edwards), 34,006 (remarks of Senator DeConcini) (1978).

or interest in the business that could not securely be brought to the aid of the continuing business without according an ownership interest to the old equity owner. In cases where the creditors believe that participation in ownership of the reorganized business by the old equity owners would increase the value of the business, they should be able to negotiate an agreement under which a portion of that increase would inure to the benefit of the creditors, and thus increase the amounts they recover on their claims. On the other hand, creditors in many cases might oppose continued participation by the old owners, either because they do not believe that continued management by the old owners would be helpful (perhaps because mismanagement by the old owners was the cause of the business's failure), or because they believe that continued assistance in management by the old owners can be ensured adequately by employment agreements, without also conferring an ownership interest in the reorganized enterprise. As a result, the provisions of Chapter 11 create a mechanism that allows the parties with an economic interest in maximizing the value of the business—the unpaid creditors—the ability to negotiate an agreement with the equity owners allowing continuing ownership participation in those cases where it is in the best interests of the creditors.²⁹

²⁹ See House Report, *supra* note 13, at 224 ("[N]egotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders. * * * Only when the parties are unable to agree on a proper distribution of the value of the company does the [Bankruptcy Code] establish a financial standard."); Walter J. Blum and Stanley A. Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U.

3. The provisions of the Code permitting a court to confirm a plan that does not meet the "fair and equitable" standard if the plan secures the requisite votes of the creditors remove any need for a court to recognize a rule that would permit prior equity owners to participate in a reorganization upon the contribution of new value. The *Case* Court discerned such an exception in the general language of the Act to deal with cases where "the necessity * * * of seeking new money [was] essential to the success of the undertaking," 308 U.S. at 121. As the *Case* opinion makes clear, that exception was designed to increase the economic prosperity of the reorganized business—and thus the recovery of the unsecured creditors—not to further some more generalized policy favoring continued participation by the old owners for its own sake.³⁰

Because the new Code includes a separate mechanism that allows creditors to decide for themselves when continued participation will increase their recovery, there is no need for courts to interpret the

Chi. L. Rev. 651, 653 (1974) ("The absolute priority doctrine can be characterized as a way of structuring negotiations so that they are sufficiently disciplined to be held within permissible areas and to permit judicial review.").

³⁰ The "necessity" to which the Court refers in *Case* is for money "essential to the success of the undertaking." Given the *Case* Court's clear premise that "creditors are entitled to priority over stockholders against all the property of an insolvent corporation," 308 U.S. at 120, and its admonition that the interest given old owners for any contributions of new value must be "reasonably equivalent to their contribution," *id.* at 121—lest "the creditor's rights * * * be easily diluted by inadequate contributions by stockholders," *id.* at 122—the *Case* Court plainly understood that any net increase in value would be applied to defray the claims of the creditors.

"fair and equitable" standard to permit participation in other circumstances. When the creditors have not consented, the parties with money at stake³¹ have expressed their view that continued participation by old equity owners on the terms proposed by the debtor would not be in the best interests of the enterprise as a whole. If the purpose of allowing the old owners to participate is to increase the recovery of the creditors—and we do not discern any other basis in the Court's opinion in *Case* or the language of the Code—courts should not second-guess the view of the creditors themselves that continued participation would not be beneficial.³²

³¹ The old owners would be entitled to a recovery from the business (and thus would have money at stake) only if their participation would be so productive that the business (under their direction) would produce sufficient funds not only to pay off the unsecured creditors, but also to produce a return for their residual interests. If the old owners believed that to be the case, they could protect their interest by causing the debtor to propose a plan that would pay off the unsecured creditors entirely, thus satisfying Section 1129(b)(2)(B)(i), and obviating the need for application of the absolute priority rule set forth in Section 1129(b)(2)(B)(ii). Of course, the judge could confirm such a plan only if it found that the plan was "not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor." Section 1129(a)(11).

³² The court of appeals in this case did not suggest that the new value rule should be used to further some general interest in continued ownership of the business by the prior owners. Rather, the court concluded (Pet. App. A50) that the absolute priority rule does not bar a plan that allows the owners of a debtor to participate in ownership of the reorganized business upon the contribution of new value because that "participation is necessary for a successful reorganization and in the best interests of all concerned." In our view, the best yardstick for measuring a "successful" reorganization under the Code is

A rule permitting judges to force creditors to accept plans that allow continuing ownership on terms that the creditors believe would not further the profitability of the business also would tend to have adverse consequences for the reorganization process as a whole. As numerous commentators have recognized, the delay and expense involved in Chapter 11 proceedings has undermined the effectiveness of that statute considerably.³³ Many commentators believe that the problems with Chapter 11 are closely related to a debtor's incentive and ability to delay those proceedings and bargain for results to which it is not entitled under the Code.³⁴ The rule adopted by the

whether it increases the value of the estate over the other available alternatives. To put it another way, a reorganization is not "successful" solely because it allows the owners of the failed business to remain in control if it at the same time decreases the recovery of the parties who have money at stake in the proceeding. For the reasons explained in the text, we believe that the court of appeals went astray in assuming that a judge is in a better position than the creditors themselves to determine what plan best increases the recovery of the creditors.

³³ See, e.g., Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 Cornell L. Rev. 439, 489 (1992); Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. Legal Stud. 127 (1986); Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 Harv. L. Rev. 775, 777-781 (1988); Michael Bradley and Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 Yale L.J. 1043 (1992); Thomas H. Jackson and Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 Va. L. Rev. 155, 190 (1989); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 Texas L. Rev. 51, 78-84 (1992).

³⁴ See, e.g., Bebchuk, *supra* note 33, at 780 & n.19 ("When the value of the reorganized company is lower than the total

court of appeals in this case would give debtors an additional incentive to delay and oppose prompt resolution of the proceedings, in the hope that they might be able to convince a judge to confirm a plan that would allow their owners to retain an interest in the business even if the owners are not able to repay all of the unsecured creditors or convince them that continued ownership would further the creditors' interests. In light of the problems arising under the current process, the Court should not adopt a rule that increases the bargaining power of a debtor beyond what it currently has.³⁵

value of creditors' claims, the equityholders might have nothing to lose and something to gain from a delay."); Bradley & Rosenzweig, *supra* note 33, at 1076-1077 ("Filing a Chapter 11 petition, in effect, is a way to keep control of the firm free from the intrusive monitoring of creditors, thereby permitting management to extract wealth from the firm's various security holders."); Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 Wis. L. Rev. 729, 731-737; Robert K. Rasmussen, *supra* note 33, at 76 ("It is clear * * * that equity holders often participate in a reorganization even where there is little probability that they are contributing firm-specific skills to the reorganized enterprise."); David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 Wis. L. Rev. 465, 515 (referring to "the hold up power currently wielded * * * by the shareholders of a Chapter 11 debtor [in a nonclosely held corporation case]").

³⁵ Empirical studies suggest that debtors under the current process generally receive significantly more in Chapter 11 plans than the absolute priority rule would permit. Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (Pt. 2), 57 Am. Bankr. L.J. 247, 263-266 (1983) [hereinafter Lopucki, *Full Control?*] (empirical study of one year's cases from the Western District of Missouri suggests that small debtors almost uniformly retain ownership of the company if it successfully reorganizes,

In sum, the differences between the confirmation provisions of the Code and those of the Act undercut the concerns that led the Court to suggest in *Case* that a contribution of new value by old equity owners might suffice to permit continued participation under a plan of reorganization. Under the framework established by the Code, any plan that permits such participation over the objection of a class of unpaid unsecured claims is—even aside from the specific requirements of Section 1129(b)(2)—not "fair and equitable" within the meaning of Section 1129(b)(1). Accordingly, Section 1129(b) does not authorize confirmation of such a plan.

B. At a minimum, the absolute priority rule does not permit confirmation of a plan that grants equity owners an exclusive right to acquire an ownership interest in the reorganized enterprise over the objection of a class of unpaid unsecured claims

As in *Ahlers*, the Court could dispose of this case without reaching the broad question discussed in

without regard to whether creditors are fully paid); Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 Marq. L. Rev. 159, 165-183 (1987) (similar conclusion based on study of cases from the Eastern District of Wisconsin). That conclusion holds true even in the reorganizations of large, publicly traded companies, where it is highly unlikely that the shareholders possess any particular skill necessary to the reorganization of the company. See Lynn M. LoPucki and William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125, 141-143 (1990) (empirical study of the bankruptcy reorganizations of large, publicly held companies shows that equity received distributions in 70% (21 out of 30) of the cases in which the creditors were not fully repaid).

Point II.A above, because the plan proposed by the debtor in this case cannot be reconciled with the language of the absolute priority rule set forth in Section 1129(b)(2)(B)(ii).

The plan in this case grants the equity owners of the debtor the right to purchase a substantial (indeed, controlling) ownership interest in the reorganized business in return for a contribution of \$200,000 and the obligation to fund any working capital shortfalls that the enterprise experiences during the first few years of operations.³⁶ The plan does not allow any other person—whether a creditor or an independent financier—an opportunity to bid for that ownership interest or to purchase a portion of it together with respondent's owners. To put it another way, the right of respondent's owners to acquire that ownership interest—which includes the entirety of the common stock to be issued at the inception of the plan—is exclusive of the rights of all third parties to bid on or otherwise acquire that interest.³⁷

³⁶ We mention the obligation to fund working-capital shortfalls for completeness, although the plan does not specify that compliance with that obligation is a condition of respondent's owners continuing to control the reorganized business. See J.A. 19 (describing obligation to fund future shortfalls but not describing any remedy for a default). Compare J.A. 20 (collateral trust mortgage to be contributed by H.F. Magnuson would be collateral only for "indebtedness assumed by the Reorganized Debtor in conjunction with this Plan").

³⁷ For an example of a court that allowed prior owners to purchase ownership interests in a reorganized business only if they were willing to pay more than other parties in a competitive auction, see *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1008-1011 (Bankr. D. Mass. 1991) (Queenan, J.). For a discussion of the practical advantages a debtor would retain even if other parties have an opportunity to compete with the

We submit that the exclusive right granted respondent's owners is a species of "property"; it closely resembles a stock warrant.³⁸ The most plausible justification for the grant is the status of those individuals and entities as owners of the debtor. That justification, however, violates the absolute priority rule set forth in Section 1129(b)(2)(B)(ii), because it results in a grant of "property" "on account of" the "junior claim or interest" held by respondent's owners.

Nor can the interest granted to the old owners be justified by stating that it is granted "on account of" their contribution of new value. To be sure, it has been argued that an ownership interest in a reorganized business that is granted to old equity owners who contribute new value is not barred directly by Section 1129(b)(2)(B)(ii), because the interest in the business is granted "on account of" the contribution of new value, rather than the status of the purchasers as prior owners.³⁹ But that argument can justify permitting prior owners to participate in ownership of a reorganized debtor only

debtor's owners for the purchase, see Lopucki, *Strategies*, *supra* note 4, § 11.11.2.

³⁸ See *Black's Law Dictionary* 1422 (5th ed. 1979) (defining stock warrant as "[a] certificate entitling the owner to buy a specified amount of stock at a specified time(s) for a specified price"). When a warrant is issued by a company whose articles of incorporation authorize the issuance of only a limited number of shares (as is customary, and as is the case here), the warrant effectively grants an exclusive right to acquire the shares in question.

³⁹ A lucid explication of that view appears in Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Survey Amer. Law 9, 39.

if they participate on the same terms as other parties. When a plan allows the old owners to participate on terms not available to others, it has given the old owners something—"property" for purposes of Section 1129(b)(2)(B)(ii)—that cannot be justified solely by reference to the contribution of value.⁴⁰ If the rights were granted solely "on account of" the value contributed, then they would be accorded to any party that is willing to make a similar contribution.⁴¹

⁴⁰ As Professor Warren explains:

The Code leaves old equity in the position of any other potential investor: it may offer to buy any of the assets of the estate on the same terms as any other buyer.

Some commentators argue that the estate is not buying on the same terms as any other buyer because it enjoys a better position than all other buyers in chapter 11. Nothing in the Code gives equity such a beneficial position. If courts are in fact giving them enhanced status, they should not do so.

Warren, *supra* note 39, at 39.

⁴¹ Nor is there merit in the suggestion of the court of appeals (Pet. App. A50) that the interest is permitted because it is granted in furtherance of "a successful reorganization and in the best interests of all concerned." The fundamental flaw in that suggestion is that it authorizes confirmation of a plan that grants an interest to a party with no claim against the debtor. Section 1129 provides that a plan of reorganization will distribute the assets and income of the estate of an insolvent business to repay the claims against the estate. Except where parties consent to different treatment, the distribution must be made in accordance with the priority of the claims (except where parties purchase assets of the estate, or an interest in the estate, a justification abjured by the court of appeals). The reasoning of the court of appeals is inconsistent with that framework, because it authorizes judges to give an interest in the reorganized business to a party on a basis other than the party's holding a claim against the debtor. Just as the Code

Finally, the fact that the plan (typically proposed by the debtor, as in this case⁴²) makes the right to acquire the ownership interests exclusive strongly suggests that—at least in the debtor's view—the right has value, in the sense that the debtor believes that the ownership interests are worth more than the price set by the plan. If the debtor did not believe that the ownership interests were worth more than the price set by the plan, it presumably would be willing to compete for the purchase with other parties. When the parties with money at stake object to that plan, the ground for that inference is particularly strong. Hence, cramdowns in exclusive-purchase cases present especially strong concerns that the debtor's owners are securing value under the plan that

expressly provides that it is not fair and equitable to grant an interest to a junior claimant while an objecting class of senior claimants is unpaid, courts should apply the general "fair and equitable" language in Section 1129(b)(1) to bar plans that vest in an interest in a party based on a claim junior to the claim held by the most junior claimant—*i.e.*, a party that has no claim whatsoever.

⁴² Section 1121(b) generally grants the debtor the exclusive right to file a plan for the first 120 days of the proceeding. As a practical matter, it appears that it is quite unusual for a judge to reject a debtor's request to extend that period. As a result, it is unusual for a party other than the debtor to propose a plan of reorganization. See Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 Wis. L. Rev. 11, 31 n.67 (empirical study of large bankruptcies indicating that debtor retained the right of exclusivity throughout the entire proceeding in 79% [34 of 43] of the cases); LoPucki, *Full Control?*, *supra* note 35, at 253-257 (rarity of creditor-proposed plans in small cases).

properly should belong to the unpaid unsecured creditors.

* * * * *

The plan proposed by respondent grants respondent's owners a right—not available to any other party—to acquire an overwhelming share of the ownership interests in the reorganized debtor. Petitioner, however—who controls an impaired class of unsecured claims—would not consent, and the plan does not provide for payment in full of the claims of that class. As a result, Section 1129 bars confirmation of the plan.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

PAUL BENDER
Deputy Solicitor General

RONALD J. MANN
Assistant to the Solicitor General

FEBRUARY 1994

APPENDIX

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable;¹

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

¹ So in original. The semicolon probably should be a period.

(1a)

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5) or 507(a)(6) of this title, each holder of a claim of such class will receive—

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor

to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930,² as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another en-

tity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to

² So in original. Probably should be section 1930 of title 28.

the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933 (15 U.S.C. 77e). In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

MAY 12 1994

No. 93-714

(15)

OFFICE OF THE CLERK

In the Supreme Court of the United States**OCTOBER TERM, 1993****U.S. BANCORP MORTGAGE COMPANY, PETITIONER***v.***BONNER MALL PARTNERSHIP**

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

**BRIEF FOR THE UNITED STATES AS AMICUS CURIAE
SUPPORTING PETITIONER**

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

EDWIN S. KNEEDLER
Deputy Solicitor General

RONALD J. MANN
Assistant to the Solicitor General

LEONARD SCHAITMAN
JOHN P. SCHNITKER
Attorneys

*Department of Justice
Washington, D.C. 20530
(202) 514-2217*

38 PP

QUESTION PRESENTED

Whether the rule of *vacatur* announced in *United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950), should apply to cases that become moot in this Court because of voluntary settlement by the parties after the Court has granted a petition for a writ of certiorari.

(I)

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statement	2
Summary of argument	4
Argument:	
I. This Court should vacate the judgment of a court of appeals if the case becomes moot as a result of settlement while the case is pending in this Court on writ of certiorari	6
A. This Court's precedents mandate a general rule of vacatur when a case that is pending on appeal or certiorari becomes moot as a result of settle- ment	10
B. Considerations of fairness and public policy support a general rule of vacatur in cases that become moot as a result of settlement while pending on appeal or certiorari	17
1. A rule of vacatur furthers the judicial sys- tem's important interest in voluntary settle- ment of disputes	17
2. The public interest in the judicial system and its decisions does not override the in- terests favoring settlement that are further- ed by a rule of vacatur	22
II. If the Court adopts a rule calling for case-by-case consideration, vacatur is appropriate in this case ...	26
Conclusion	30

TABLE OF AUTHORITIES

Cases:	
<i>A.L. Mechling Barge Lines, Inc. v. United States</i> , 368 U.S. 324 (1961)	17
<i>Allen & Co. v. Pacific Dunlop Holdings, Inc.</i> , 114 S. Ct. 1146 (1994)	12

Cases—Continued:

	Page
<i>Alliance To End Repression v. City of Chicago</i> , 820 F.2d 873 (7th Cir. 1987)	24
<i>Anderson, In re</i> , 913 F.2d 530 (8th Cir. 1990)	29-30
<i>Arthur v. Manch</i> , 12 F.3d 377 (2d Cir. 1993)	16
<i>Bates v. Union Oil Co.</i> , 944 F.2d 647 (9th Cir. 1991), cert. denied, 112 S. Ct. 1761 (1992)	19
<i>Baxter Healthcare Corp. v. Healthdyne, Inc.</i> , 956 F.2d 226 (11th Cir. 1992)	8
<i>Bethune Plaza, Inc. v. Lumpkin</i> , 863 F.2d 525 (7th Cir. 1988)	24
<i>Black v. Amen</i> , 355 U.S. 600 (1958)	10-11
<i>Black v. Cutter Laboratories</i> , 351 U.S. 292 (1956)	24
<i>Board of Governors of Federal Reserve System v. Security Bancorp</i> , 454 U.S. 1118 (1981)	15
<i>Board of Regents v. New Left Education Project</i> , 414 U.S. 807 (1973)	16
<i>Bowen v. Kizer</i> , 485 U.S. 386 (1988)	16
<i>Buck's Stove & Range Co. v. American Federation of Labor</i> , 219 U.S. 581 (1911)	7, 11
<i>California v. Rooney</i> , 483 U.S. 307 (1987)	24
<i>Chemetron Corp. v. Business Funds, Inc.</i> , 682 F.2d 1149 (5th Cir. 1982), vacated and remanded, 460 U.S. 1007 (1983)	18-19
<i>Church of Scientology v. United States</i> , 113 S. Ct. 447 (1992)	7
<i>City Gas Co. v. Consolidated Gas Co.</i> , 499 U.S. 915 (1991)	10
<i>Clarendon Ltd. v. Nu-West Industries, Inc.</i> , 936 F.2d 127 (3d Cir. 1991)	8, 22
<i>Clarke v. United States</i> , 915 F.2d 699 (D.C. Cir. 1990)	9
<i>Commercial Cable Co. v. Burleson</i> , 250 U.S. 360 (1919) ..	15
<i>Continental Casualty Co. v. Fibreboard Corp.</i> , 113 S. Ct. 399 (1992)	10, 11
<i>County of Los Angeles v. Davis</i> , 440 U.S. 625 (1979)	19, 20
<i>DHL Corp. v. CAB</i> , 659 F.2d 941 (9th Cir. 1981)	19

Cases—Continued:

	Page
<i>Dakota County v. Glidden</i> , 113 U.S. 222 (1885)	11
<i>DeFunis v. Odegaard</i> , 416 U.S. 312 (1974)	15
<i>Deakins v. Monaghan</i> , 484 U.S. 193 (1988)	7, 15
<i>Dodrill v. Lutd</i> , 764 F.2d 442 (6th Cir. 1985)	19
<i>Duke Power Co. v. Greenwood County</i> , 299 U.S. 259 (1936)	10
<i>Federal Data Corp. v. SMS Data Products Group, Inc. Inc.</i> , 819 F.2d 277 (Fed. Cir. 1987)	7, 18
<i>Frank v. Minnesota Newspaper Ass'n</i> , 490 U.S. 225 (1989)	15
<i>Gray v. Board of Trustees</i> , 342 U.S. 517 (1952)	15
<i>Great Western Sugar Co. v. Nelson</i> , 442 U.S. 92 (1979) .	10
<i>Hammond Clock Co. v. Schiff</i> , 293 U.S. 529 (1934)	7, 11
<i>Hendrickson v. Secretary of Health & Human Services</i> , 774 F.2d 1355 (8th Cir. 1985)	8
<i>Hewitt v. Helms</i> , 482 U.S. 755 (1987)	24
<i>Honig v. Doe</i> , 484 U.S. 305 (1988)	7
<i>Honig v. Students of California School for the Blind</i> , 471 U.S. 148 (1985)	16
<i>Iron Arrow Honor Society v. Heckler</i> , 464 U.S. 67 (1983)	6-7
<i>J. Aron & Co. v. Mississippi Shipping Co.</i> , 361 U.S. 115 (1959)	10
<i>Kaisha v. U.S. Philips Corp.</i> , 114 S. Ct. 425 (1993)	8
<i>Karcher v. May</i> , 484 U.S. 72 (1987)	12, 14
<i>Kennedy v. Block</i> , 784 F.2d 1220 (4th Cir. 1986)	8
<i>Key Enterprises, Inc. v. Venice Hospital</i> , 9 F.3d 893 (11th Cir. 1993), petition for cert. pending, No. 93-1365	9
<i>Lake Coal Co. v. Roberts & Schaefer Co.</i> , 474 U.S. 120 (1985)	7, 10, 11
<i>Lewis v. Continental Bank Corp.</i> , 494 U.S. 472 (1990) ..	7
<i>Long Island Lighting Co. v. Cuomo</i> , 888 F.2d 230 (2d Cir. 1989)	14, 19

Cases—Continued:	Page
<i>Manufacturers Hanover Trust Co. v. Yanakas</i> , 11 F.3d 381 (2d Cir. 1993)	7-8, 9, 16
<i>Marc Development, Inc. v. FDIC</i> , 12 F.3d 948 (10th Cir. 1993)	9
<i>Marek v. Chesny</i> , 473 U.S. 1 (1985)	18
<i>Marshall v. Whittaker Corp.</i> , 610 F.2d 1141 (3d Cir. 1979)	19
<i>Martinez v. Winner</i> , 800 F.2d 230 (10th Cir. 1986)	19
<i>Memorial Hospital, Inc., In re</i> , 862 F.2d 1299 (7th Cir. 1988)	8, 13, 20, 21, 22, 24
<i>Mills v. Green</i> , 159 U.S. 651 (1895)	7
<i>Montana v. United States</i> , 440 U.S. 147 (1979)	23
<i>National Union Fire Insurance Co. v. Seafirst Corp.</i> , 891 F.2d 762 (9th Cir. 1989)	8, 13
<i>Nestle Co. v. Chester's Market, Inc.</i> , 756 F.2d 280 (2d Cir. 1985)	7, 19, 24
<i>No East-West Highway Committee, Inc. v. Chandler</i> , 767 F.2d 21 (1st Cir. 1985)	19
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988)	29
<i>Oklahoma Radio Associates v. FDIC</i> , 3 F.3d 1436 (10th Cir. 1993)	8, 9
<i>Pontarelli Limousine, Inc. v. City of Chicago</i> , 929 F.2d 339 (7th Cir. 1991)	19
<i>Preiser v. Newkirk</i> , 422 U.S. 395 (1975)	16
<i>Quarles v. Sager</i> , 687 F.2d 344 (11th Cir. 1982)	19
<i>Radiofone, Inc. v. FCC</i> , 759 F.2d 936 (D.C. Cir. 1985)	17
<i>Ringsby Truck Lines, Inc. v. Western Conference of Teamsters</i> , 686 F.2d 720 (9th Cir. 1982)	8, 13, 26
<i>Savidge v. Fincannon</i> , 836 F.2d 898 (5th Cir. 1988)	19
<i>Silvey v. Soler</i> , 113 S. Ct. 454 (1992)	9
<i>Sosna v. Iowa</i> , 419 U.S. 393 (1975)	7
<i>Steffel v. Thompson</i> , 415 U.S. 452 (1974)	7
<i>Stewart v. Southern Railway</i> , 315 U.S. 784 (1942)	11

Cases—Continued:	Page
<i>Studio 1712, Inc. v. Etna Products Co.</i> , 968 F.2d 10 (10th Cir. 1992)	8
<i>U.S. Truck Co., In re</i> , 800 F.2d 581 (6th Cir. 1986)	30
<i>United States, In re</i> , 927 F.2d 626 (D.C. Cir. 1991)	8, 13, 22, 27
<i>United States v. Alaska Steamship Co.</i> , 253 U.S. 113 (1920)	7
<i>United States v. Articles of Drug Consisting of 203 Paper Bags</i> , 818 F.2d 569 (7th Cir. 1987)	19
<i>United States v. Mendoza</i> , 464 U.S. 154 (1984)	1
<i>United States v. Munsingwear, Inc.</i> , 340 U.S. 36 (1950)	4, 10, 12, 13, 19
<i>Velsicol Chemical Corp. v. United States</i> , cert. denied, 435 U.S. 942 (1978)	9
<i>Webster v. Reproductive Health Services</i> , 492 U.S. 490 (1989)	15
<i>Weinstein v. Bradford</i> , 423 U.S. 147 (1975)	16
<i>Williams v. First National Bank</i> , 216 U.S. 582 (1910)	18
 Constitution, statutes and rules:	
<i>U.S. Const. Art. III</i>	5, 6, 17, 23, 25
 Bankruptcy Code (11 U.S.C.):	
Ch. 3:	
11 U.S.C. 362(a)	2
Ch. 11	2, 3
11 U.S.C. 1129(a)	3
11 U.S.C. 1129(b)	3
11 U.S.C. 1129(b)(2)(B)(ii)	3
11 U.S.C. 1129(b)(2)(C)(ii)	3
Sup. Ct. R.:	
Rule 46	4, 12
Rule 46.1	12
 Miscellaneous:	
<i>Jill E. Fisch, Rewriting History: The Propriety of Eradicating Prior Decisional Law Through Settlement and Vacatur</i> , 76 Cornell L. Rev. 589 (1991)	20

Miscellaneous—Continued:

	Page
Arthur F. Greenbaum, <i>Mootness on Appeal in Federal Courts: A Reexamination of the Consequences of Appellate Disposition</i> , 17 U.C. Davis L. Rev. 7 (1983)	9, 11, 17, 19, 20, 21
1B James Wm. Moore et al., <i>Moore's Federal Practice</i> (2d ed. 1993)	19
Note, <i>Avoiding Issue Preclusion by Settlement Conditioned upon the Vacatur of Entered Judgments</i> , 96 Yale L.J. 860 (1987)	18
Note, <i>Collateral Estoppel and Supreme Court Disposition of Moot Cases</i> , 78 Mich. L. Rev. 946 (1980)	9
Note, <i>Collateral Estoppel Effects of Judgments Vacated Pursuant to Settlement</i> , 1987 U. Ill. L. Rev. 731	11
Note, <i>Settlement Pending Appeal: An Argument for Vacatur</i> , 58 Fordham L. Rev. 233 (1989)	18, 19
George L. Priest & Benjamin Klein, <i>The Selection of Disputes for Litigation</i> , 13 J. Legal Stud. 1 (1984)	20
Peter H. Schuck, <i>The Role of Judges in Settling Complex Cases: The Agent Orange Example</i> , 53 U. Chi. L. Rev. 337 (1986)	20
Robert L. Stern et al., <i>Supreme Court Practice</i> (7th ed. 1993)	9
<i>The Supreme Court—Leading Cases</i> , 107 Harv. L. Rev. 144 (1993)	18
Hubert L. Will et al., <i>The Role of the Judge in the Settlement Process</i> , 75 F.R.D. 203 (1976)	18
Charles Alan Wright et al., <i>Federal Practice and Procedure</i> : Vol. 13A (2d ed. 1984)	9, 16, 25
Vol. 13A (Supp. 1994)	9, 21, 24-25
Vol. 18 (1981)	19

In the Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-714

U.S. BANCORP MORTGAGE COMPANY, PETITIONER*v.***BONNER MALL PARTNERSHIP**

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

**BRIEF FOR THE UNITED STATES AS AMICUS CURIAE
SUPPORTING PETITIONER**

INTEREST OF THE UNITED STATES

The federal government "is a party to a far greater number of cases on a nationwide basis than even the most litigious private entity." *United States v. Mendoza*, 464 U.S. 154, 159 (1984). As a party to numerous cases in the federal judicial system that involve recurring issues of public importance (*id.* at 159-163), the federal government is vitally interested in the question of whether vacatur is appropriate when parties settle cases on appeal.

(1)

STATEMENT¹

1. In 1984 and 1985, an entity named Northtown Investments built the Bonner Mall in Bonner County, Idaho. Northtown financed construction of the mall with a loan from First National Bank of North Idaho; petitioner now holds that loan. In October of 1986, Northtown sold the mall to respondent, subject to the mortgage that secures repayment of the loan held by petitioner. When respondent failed to comply with its obligations under the mortgage, petitioner exercised its right to schedule the property for a foreclosure sale. See Pet. App. A4-A5, A91-A92.

2. On the day before the sale, respondent filed a petition in the United States Bankruptcy Court for the District of Idaho, seeking relief under Chapter 11 of the Bankruptcy Code. Petitioner sought relief from the automatic stay imposed by 11 U.S.C. 362(a) so that it could proceed with its foreclosure. The bankruptcy court eventually granted relief, based on its conclusion that there was not a reasonable possibility of a successful reorganization within a reasonable time. That conclusion rested on the court's legal determination that Chapter 11 of the Bankruptcy Code does not permit approval of a plan under which the owners of the failed enterprise retain an ownership interest in the reorganized business over the objection of unpaid creditors, even if the ownership share rests on "new value" contributed by the owners. J.A. 29-33; see Pet. App. A5-A8, A92-A97.

3. The district court reversed. Pet. App. A90-A117. It concluded that Chapter 11 of the Bankruptcy Code permits owners to participate in reorganizations if they contribute new

¹ A more detailed statement of the facts and procedural history of the case appears in the amicus brief on the merits that the United States filed in support of petitioner in February 1994. For convenience, this brief refers to that earlier brief as "U.S. Br."

value, even if the creditors object (a rule generally referred to as the new-value exception to the absolute priority rule²). Pet. App. A98-A116.

4. The court of appeals affirmed. That court agreed with the district court's conclusion that Chapter 11 of the Bankruptcy Code includes the new-value exception. Pet. App. A1-A84.

5. On January 10, 1994, this Court granted a petition for a writ of certiorari to review the propriety of the court of appeals' acceptance of the new-value exception. 114 S. Ct. 681.

6. On March 2, 1994, petitioner and respondent stipulated to the confirmation of a consensual plan of reorganization.³ On March 10, 1994, the bankruptcy court entered an order confirming that plan. Because petitioner consented to the plan, it was confirmed by the bankruptcy court under 11 U.S.C. 1129(a). Accordingly, the court had no occasion to consider the propriety of a new-value exception, which is at issue only in cases in which the court is asked to confirm a plan over the objection of creditors, under 11 U.S.C. 1129(b). The agreement of the parties did not address the question whether the judgment of the court of appeals should be vacated. See Memorandum of Respondent Suggesting that the Case Is Moot at 2-3 & Exhs. A, B [hereinafter Resp. Mem.].

² The absolute priority rule is the rule set forth in 11 U.S.C. 1129(b)(2)(B)(ii) & (C)(ii), which generally gives creditors absolute priority over equity holders in the assets of a bankruptcy estate. See U.S. Br. 12 & n.16.

³ That settlement occurred pursuant to a January 7, 1994, agreement of the parties that was subject to certain conditions to be performed by respondent and its partners. See Memorandum of Respondent Suggesting that the Case Is Moot at 2. Neither the papers filed at the petition stage nor petitioner's brief informed the Court of that agreement. The United States was not aware of the agreement until after it had filed its brief in support of petitioner.

7. Respondent filed a memorandum in this Court suggesting that the case is moot and moving the Court for dismissal of the petition under Rule 46 of the Rules of this Court. Resp. Mem. 3. Petitioner responded, agreeing that the case is moot, but asking the Court to vacate the judgment of the court of appeals in accordance with *United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950). Response of Petitioner to Memorandum of Respondent Suggesting that the Case Is Moot. The parties filed another round of pleadings reiterating their views. See Respondent's Reply to Response of Petitioner [hereinafter Resp. Reply]; Petitioner's Reply in Support of Request To Vacate Decision Below. On March 28, 1994, the Court removed the case from the calendar for the April 1994 argument session and asked for briefing and oral argument on the question whether *Munsingwear* makes it appropriate for the Court to vacate the decision of the court of appeals.

SUMMARY OF ARGUMENT

I. Under *United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950), federal courts generally are required to grant a motion to vacate the judgment below when a case becomes moot while the process of appellate review is ongoing. That practice should apply whether the case becomes moot because of "happenstance"—i.e., for reasons external to the case—or because of settlement.

A. This Court consistently has followed the *Munsingwear* procedure in cases that have become moot by reason of the parties' settlement while the case is pending in this Court. To be sure, *Munsingwear* itself involved mootness that arose from "happenstance" rather than agreement of the parties, but *Munsingwear* announces a categorical rule of vacatur upon mootness, and this Court's cases have not limited *Munsingwear* to cases of mootness by happenstance. Rather, vacatur is appropriate whenever a case in which appellate review is ongoing becomes moot as a result of external events, the

mutual agreement of the parties, or the unilateral conduct of the party that prevailed below. In either of the latter two situations, the decision of the party that prevailed in the lower court to forgo reliance on the lower court's judgment as a proper resolution of the underlying dispute justifies vacatur of the judgment, which has become unreviewable as a result of the action of the prevailing party.

B. The Court's established practice of vacating a lower-court judgment when a pending case becomes moot as a result of the parties' settlement is consistent with considerations of fairness and public policy. The law strongly favors voluntary settlement of disputes because it fosters judicial economy, economic efficiency, and the public and private interests in the just resolution of disputes. A general rule of vacatur upon settlement furthers those interests by removing disincentives to settlement in cases that are pending on appeal. Absent vacatur, settlement will be impossible to achieve in cases in which the losing party regards the preclusive or precedential effects of the judgment below as unacceptable. That concern is particularly strong in cases involving the government and other institutional litigants, for whom the preclusive and precedential effects of an adverse judgment may be more significant than its more immediate impact or the cost of settlement.

Although some courts have identified a number of countervailing considerations, particularly the public's interest in the judicial system and its decisions, those considerations do not outweigh the interests furthered by a rule of vacatur. In most cases, it is speculative to conclude that preservation of the precedent would foster judicial economy by significantly limiting the need for future litigation of the issues. Because settlement in each case offers an immediate and certain benefit by ending the controversy before the court—the only controversy adequate to justify an exercise of the court's Article

III powers—the interest in a rule encouraging settlement should prevail.

Nor should the rule be limited to cases in which both parties seek vacatur of the lower court's decision. A rule limiting vacatur to such cases would prevent settlements where the parties can resolve their existing dispute, solely because of the inability of the parties to agree on how to resolve hypothetical future disputes. The interest in encouraging settlement, coupled with the attenuated significance to an Article III court of future hypothetical disputes, counsels in favor of applying the rule of vacatur in such cases.

II. If the Court rejects a general rule of vacatur in favor of an ad hoc approach, we submit that a proper balancing of the relevant interests would lead to the conclusion that vacatur is appropriate in this case. This is not a situation in which the party that lost below has rendered the case moot by relinquishing its efforts to overturn the lower court's decision. Rather, the settlement agreed to by the parties reflects respondent's unwillingness to insist on the rights accruing to it under the judgment of the lower court. Furthermore, vacatur of that judgment would alleviate the conflict in the circuits that created the need for review by this Court. Accordingly, the interests of the public would not be served by leaving in place the precedential effects of the decision of the court of appeals.

ARGUMENT

I. THIS COURT SHOULD VACATE THE JUDGMENT OF A COURT OF APPEALS IF THE CASE BECOMES MOOT AS A RESULT OF SETTLEMENT WHILE THE CASE IS PENDING IN THIS COURT ON WRIT OF CERTIORARI

"Federal courts lack jurisdiction to decide moot cases because their constitutional authority extends only to actual cases or controversies." *Iron Arrow Honor Society v. Heck-*

ler, 464 U.S. 67, 70 (1983) (per curiam); see *Church of Scientology v. United States*, 113 S. Ct. 447, 449 (1992); *Deakins v. Monaghan*, 484 U.S. 193, 199 (1988). A corollary to that basic principle is that the parties' dispute must exist at every stage of the litigation. "It is not enough that a controversy existed at the time the complaint was filed." *Deakins*, 484 U.S. at 199; *Sosna v. Iowa*, 419 U.S. 393, 402 (1975); *Steffel v. Thompson*, 415 U.S. 452, 459 n.10 (1974); see also *Honig v. Doe*, 484 U.S. 305, 329 (1988) (Rehnquist, C.J., concurring). "[A]n actual controversy must exist at all stages of appellate review." *Honig*, 484 U.S. at 329 (Rehnquist, C.J., concurring); see *Lewis v. Continental Bank Corp.*, 494 U.S. 472, 477-478 (1990).

In accordance with the foregoing principles, this Court repeatedly has held that a settlement agreement that fully resolves the dispute between the parties renders the case moot and thereby deprives the Court of jurisdiction to decide the case on the merits.⁴ If the settlement occurs while appellate review is ongoing, however, a further question arises: What effect should the settlement-induced mootness have on the judgment already entered by the lower court?⁵ In

⁴ See *Lake Coal Co. v. Roberts & Schaefer Co.*, 474 U.S. 120, 120 (1985) (per curiam); *Hammond Clock Co. v. Schiff*, 293 U.S. 529, 530 (1934) (per curiam); *United States v. Alaska Steamship Co.*, 253 U.S. 113, 116 (1920) ("Where by an act of the parties * * * the existing controversy has come to an end, the case becomes moot and should be treated accordingly."); *Buck's Stove & Range Co. v. American Federation of Labor*, 219 U.S. 581, 581 (1911) (per curiam); *Mills v. Green*, 159 U.S. 651, 654 (1895); see also *Honig*, 484 U.S. at 341 (Scalia, J., dissenting) (discussing constitutional underpinnings of that rule).

⁵ The courts of appeals faced with cases that become moot by settlement while pending before them have resolved that question in different ways. The Second and Federal Circuits have adopted a general rule in favor of vacating a judgment under review when a case is settled on appeal. See, e.g., *Nestle Co. v. Chester's Market, Inc.*, 756 F.2d 280, 283-284 (2d Cir. 1985); *Federal Data Corp. v. SMS Data Products Group, Inc.*, 819 F.2d 277, 279-280 (Fed. Cir. 1987). But cf. *Manufacturers Hanover Trust Co. v.*

our view, both this Court's precedents and considerations of fairness and public policy support a general rule of vacatur of lower-court judgments when settlement renders a case moot while appellate review of the case is ongoing.⁶

Yanakas, 11 F.3d 381, 384-385 (2d Cir. 1993) (different rule if case settles after issuance of judgment by court of appeals) (discussed at note 6, *infra*). Similarly, the Fourth, Eighth, Tenth, and Eleventh Circuits appear to grant vacatur when settlement renders a case moot while on appeal, although those courts have not addressed the question at length. See, e.g., *Kennedy v. Block*, 784 F.2d 1220, 1225 (4th Cir. 1986); *Hendrickson v. Secretary of Health & Human Services*, 774 F.2d 1355, 1355 (8th Cir. 1985) (vacating own judgment); *Studio 1712, Inc. v. Etna Products Co.*, 968 F.2d 10 (10th Cir. 1992); *Baxter Healthcare Corp. v. Healthdyne, Inc.*, 956 F.2d 226, 227 (11th Cir. 1992) (vacating own judgment). But cf. *Oklahoma Radio Associates v. FDIC*, 3 F.3d 1436, 1444-1445 (10th Cir. 1993) (different rule if case settles after issuance of judgment by court of appeals) (discussed at note 6, *infra*). The Third, Seventh, and District of Columbia Circuits, on the other hand, uniformly decline to grant vacatur upon settlement. See, e.g., *Clarendon Ltd. v. Nu-West Industries, Inc.*, 936 F.2d 127, 128-130 (3d Cir. 1991); *In re Memorial Hospital, Inc.*, 862 F.2d 1299, 1301-1303 (7th Cir. 1988); *In re United States*, 927 F.2d 626, 627-628 (D.C. Cir. 1991). Finally, the Ninth Circuit employs a balancing approach, under which the propriety of vacatur depends upon the relative weight of the public and private interests at stake in a particular case. *National Union Fire Insurance Co. v. Seafirst Corp.*, 891 F.2d 762, 765-769 (9th Cir. 1989); *Ringsby Truck Lines, Inc. v. Western Conference of Teamsters*, 686 F.2d 720, 721-722 (9th Cir. 1982).

The Court granted certiorari to resolve that issue in *Kaisha v. U.S. Philips Corp.*, 113 S. Ct. 1249 (1993), but the Court dismissed the writ without reaching the vacatur issue because the petitioner, which was objecting to vacatur, was not a party to the case. 114 S. Ct. 425 (1993) (per curiam). The United States supported a general rule of vacatur upon settlement in its amicus brief in *Kaisha*.

⁶ In this brief we refer to the process of appellate review as ongoing in this Court only after the Court has granted plenary review. We consistently have argued that different considerations should apply when a case becomes moot while a petition for certiorari is pending before this Court but has not yet been granted, because the decision whether to grant review on any issue (including mootness) is discretionary with the Court. See, e.g.,

U.S. Br. in Opp. at 5-8, *Velsicol Chemical Corp. v. United States*, cert. denied, 435 U.S. 942 (1978) (No. 77-900) (arguing that Court should deny certiorari in moot cases that would not have warranted review on the merits); see *Clarke v. United States*, 915 F.2d 699, 713-715 (D.C. Cir. 1990) (en banc) (Edwards, J., dissenting); Robert L. Stern et al., *Supreme Court Practice* § 18.5, at 724 n.29 (7th ed. 1993) (discussing *Velsicol* doctrine and stating that the Court appears to follow the argument advanced in the U.S. brief in that case); Note, *Collateral Estoppel and Supreme Court Disposition of Moot Cases*, 78 Mich. L. Rev. 946, 953-958 (1980); see also, e.g., Petition for a Writ of Certiorari at 7-13, *Sivley v. Soler*, 113 S. Ct. 454 (1992) (No. 92-86) (petition seeking *Munsingwear* order where case creating circuit conflict became moot before government could seek review in this Court). But see 13A Charles Alan Wright et al., *Federal Practice and Procedure* § 3533.10, at 432-435 (2d ed. 1984 & Supp. 1994) (disapproving *Velsicol* doctrine and stating that vacatur under *Munsingwear* is always appropriate when case becomes moot before Court grants certiorari); Arthur F. Greenbaum, *Mootness on Appeal in Federal Courts: A Reexamination of the Consequences of Appellate Disposition*, 17 U.C. Davis L. Rev. 7, 43-48 (1983) (same).

At least one court of appeals has relied on the discretionary nature of review by certiorari as one of a number of considerations that would support a court of appeals' decision not to vacate its own judgment if the parties settle after entry of judgment by the court of appeals. *Manufacturers Hanover Trust Co.*, 11 F.3d at 384-385 (2d Cir. 1993); see also *Oklahoma Radio Associates*, 3 F.3d at 1444-1445 (10th Cir. 1993) (applying multi-factored test and declining to vacate its own judgment in case in which parties settled after entry of judgment by court of appeals, but while petition for rehearing was pending). Whatever the merits of those rulings, we believe that vacatur is appropriate in cases in which the parties settle after the court of appeals decides to review a case en banc. See *Key Enterprises, Inc. v. Venice Hospital*, 9 F.3d 893, 896-900 (11th Cir. 1993) (en banc), petition for cert. pending, No. 93-1365; *Marc Development, Inc. v. FDIC*, 12 F.3d 948 (10th Cir. 1993) (en banc). That situation closely resembles a case in which this Court already has granted certiorari, thus transforming the possibility of discretionary review into an active process of ongoing review. Hence, under the analysis in this brief, vacatur is appropriate.

A. This Court's Precedents Mandate A General Rule Of Vacatur When A Case That Is Pending On Appeal Or Certiorari Becomes Moot As A Result Of Settlement

In *United States v. Munsingwear, Inc.*, 340 U.S. 36 (1950), this Court stated that “[t]he established practice of the Court in dealing with a civil case from a court in the federal system which has become moot while on its way here or pending our decision on the merits is to reverse or vacate the judgment below and remand with a direction to dismiss.” *Id.* at 39. In keeping with that established practice, the Court repeatedly has emphasized that “[w]here it appears upon appeal that the controversy has become entirely moot, it is the *duty* of the appellate court to set aside the decree below and to remand the cause with directions to dismiss.” *Great Western Sugar Co. v. Nelson*, 442 U.S. 92, 93 (1979) (per curiam) (quoting *Duke Power Co. v. Greenwood County*, 299 U.S. 259, 267 (1936) (per curiam)) (emphasis supplied by *Nelson* Court).

Since *Munsingwear* was decided in 1950, and for some years earlier, this Court appears to have followed the *Munsingwear* procedure consistently in cases that became moot as a result of settlement while pending before the Court. E.g., *Continental Casualty Co. v. Fibreboard Corp.*, 113 S. Ct. 399 (1992);⁷ *City Gas Co. v. Consolidated Gas Co.*, 499 U.S. 915 (1991);⁸ *Lake Coal Co. v. Roberts & Schaefer Co.*, 474 U.S. 120 (1985) (per curiam); *J. Aron & Co. v. Mississippi Shipping Co.*, 361 U.S. 115 (1959) (per curiam);⁹ *Black v. Amen*, 355 U.S.

⁷ See Motion to Grant, Vacate and Remand on Grounds of Mootness at 1-2, No. 91-1993 (O.T. 1992).

⁸ See Joint Motion To Grant Certiorari, Vacate Judgment of Court of Appeals, and Remand with Directions To Vacate Judgment of District Court on Grounds of Mootness, No. 90-953.

⁹ The petitioner in that case suggested to the Court that the case was moot, without requesting any particular disposition. See Memorandum of

600 (1958) (per curiam); *Stewart v. Southern Railway*, 315 U.S. 784 (1942) (per curiam);¹⁰ *Hammond Clock Co. v. Schiff*, 293 U.S. 529, 530 (1934) (per curiam).¹¹ Although most of those cases involved joint requests for vacatur, some, like this one, involved situations in which the prevailing party in the lower court did not agree to vacatur, although a settlement had rendered the case unreviewable. See *Continental Casualty Co.*, *supra* (despite opposition by respondent indemnitee, Court remanded for mootness determination requested by petitioner indemnitor after petitioner settled the underlying dispute pending in a lower court); *Lake Coal Co.*, 474 U.S. at 120 (parties asked Court to decide questions presented in petition “despite complete settlement of the underlying causes of action”). Whenever the dispute becomes unreviewable because of settlement, the decision of the party that prevailed in the lower court to forgo reliance on the judgment as a proper resolution of the underlying dispute justifies vacatur of that judgment, because it has become

Petitioner, No. 450 (O.T. 1959). Counsel for the respondent informed the Clerk of the Court in a November 3, 1959, telegram that it would not oppose petitioner’s suggestion of mootness and “respectfully suggest[ed] that [the] Court must dismiss [the] petition as [a] matter of routine.” The memorandum and telegram are in the case file in the National Archives.

¹⁰ See Motion by Petitioner and Respondent To Dispose of This Cause as Moot, No. 161 (O.T. 1941).

¹¹ Commentators have noted the consistency of the Court’s recent practice with respect to settled cases. See, e.g., Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 39 & n.144; Note, *Collateral Estoppel Effects of Judgments Vacated Pursuant to Settlement*, 1987 U. Ill. L. Rev. 731, 749. For older decisions taking a different approach, see *Buck’s Stove & Range Co. v. American Federation of Labor*, 219 U.S. 581 (1911) (per curiam) (dismissing appeal in response to settlement); *Dakota County v. Glidden*, 113 U.S. 222 (1885) (dismissing writ of error after settlement).

unreviewable as a result of the action of that party in entering into the settlement agreement.¹²

Munsingwear itself, of course, did not involve mootness resulting from settlement. In *Munsingwear*, the government previously had brought suit to enjoin violations of certain price control regulations. The district court entered judgment against the government. While the government's appeal was pending, the commodity at issue was decontrolled. The defendant then moved to dismiss the government's appeal as moot, and the court of appeals granted that motion. 340 U.S. at 37. In rejecting the government's subsequent attempt to avoid the res judicata effects of the district court's prior judgment, the Court observed that the government, through "orderly procedure," could have "prevent[ed] [the] judgment, unreviewable because of mootness, from spawning any legal

¹² Vacatur is not required when the parties' settlement agreement merely contemplates dismissal of the writ of certiorari pursuant to this Court's Rule 46. In that circumstance, the parties effectively have decided to be bound by the judgment below, and thus the case is no different from one in which the losing party simply decides not to seek review in this Court. See, e.g., *Allen & Co. v. Pacific Dunlop Holdings, Inc.*, 114 S. Ct. 1146 (1994) (dismissing writ of certiorari pursuant to Rule 46). Rule 46, of course, does not apply here, because this is not a case in which "all parties * * * [have] agree[d] * * * that a case be dismissed," Rule 46.1.

For similar reasons, as we explain below (at pages 14-16, *infra*) in our discussion of *Karcher v. May*, 484 U.S. 72, 82-83 (1987), vacatur is not appropriate when the losing party simply declines to appeal or unilaterally withdraws its appeal. In such instances, the case may be over, but it is not "moot." To the contrary, the losing party has decided to accept the judgment as defining its legal obligations with respect to the subject matter of the lawsuit. By contrast, when the parties jointly adopt a resolution of their dispute that differs from the resolution reached by the existing judgment (and that resolution is implemented by the trial court if necessary, as in this case), the losing party has persuaded the prevailing party to forgo relying on the existing judgment as a proper resolution of their underlying dispute. Accordingly, the principle of *Munsingwear* calls for vacatur of that judgment.

consequences" merely by asking that the district court's judgment be vacated as moot, rather than acquiescing in the dismissal of its appeal. *Id.* at 41. The Court explained:

That procedure clears the path for future relitigation of the issues between the parties and eliminates a judgment, review of which was prevented through happenstance. When that procedure is followed, the rights of all parties are preserved; none is prejudiced by a decision which in the statutory scheme was only preliminary.

Id. at 40.

Because *Munsingwear* itself involved mootness by what the Court labeled "happenstance," 340 U.S. at 40, some courts of appeals have concluded that *Munsingwear* should be limited to that context, refusing to apply it in cases in which mootness results from the actions of the parties themselves.¹³ Nothing in the rationale of *Munsingwear*, however, supports limiting vacatur to cases in which mootness occurs by "happenstance." The Court used that term only as a description of the way in which the judgment in *Munsingwear* itself became unreviewable. The rule of vacatur the Court announced for cases that have become moot was stated in categorical terms. 340 U.S. at 39. In a case such as *Munsingwear*, the fact that the case was rendered moot by "happenstance"—i.e., by factors extrinsic to the case or beyond the control of the parties—explains why the lower-court judgment should be vacated on the motion of just one of the parties (the losing party below, which has been prevented from obtaining appellate review), even if the prevailing party does not join in seeking (or indeed opposes) vacatur. A case rendered moot by settlement is another such situation. The

¹³ See, e.g., *In re United States*, 927 F.2d at 627-628; *National Union Fire Insurance Co.*, 891 F.2d at 766; *In re Memorial Hospital*, 862 F.2d at 1301; *Ringsby Truck Lines*, 686 F.2d at 721.

agreement of the prevailing party below is necessary for the settlement to be effective. Vacatur accordingly is a suitable and natural consequence of the decision by the prevailing party both to join in the action that has rendered the case moot and to forgo the benefits of the judgment below, even if, as here, the prevailing party opposes vacatur.

In seeking to confine *Munsingwear* to instances of mootness by “happenstance,” respondent relies (Resp. Reply 1-2) on *Karcher v. May*, 484 U.S. 72, 82-83 (1987). In that case, former state legislative officials, purporting to act on behalf of the legislature, attempted to take an appeal to this Court from a lower court’s judgment invalidating a state statute. While the case was pending in this Court, the appellants’ successors in office withdrew the appeal. The Court rejected the appellants’ request to vacate the judgment below under *Munsingwear*, explaining (484 U.S. at 83):

This controversy did not become moot due to circumstances unattributable to any of the parties. The controversy ended when the losing party—the New Jersey Legislature—declined to pursue its appeal. Accordingly, the *Munsingwear* procedure is inapplicable to this case.

Contrary to petitioner’s contention, *Karcher* does not render *Munsingwear* inapplicable when mootness results from the mutual agreement of the parties. Withdrawal of the appeal in *Karcher* did not render the dispute moot, any more than any losing party’s decision to forgo further review of a judgment has that effect; rather, the case simply ended when the judgment of the lower court was rendered final and unreviewable by withdrawal of the only appeal any party had filed from that judgment. See *Long Island Lighting Co. v. Cuomo*, 888 F.2d 230, 233, 234 n.4 (2d Cir. 1989). In this case, by contrast, petitioner, which lost in the lower court, has not withdrawn its petition for a writ of certiorari, and it continues to seek to have the judgment of the court of appeals set aside.

Our understanding of *Karcher* is confirmed by a series of decisions, both before and after *Karcher*, in which this Court has applied *Munsingwear* to cases that became moot based on the conduct of the parties. Those cases have included not only the situation discussed above—in which the parties agreed to a settlement—but also a number of cases in which the party that prevailed in the lower court rendered the case moot by receding from its position. For example, in *Deakins*, 484 U.S. at 199-200, the respondents (plaintiffs in the district court) chose to withdraw their claims while the case was pending before this Court. Applying *Munsingwear*, the Court vacated the judgment below and remanded with directions to dismiss. 484 U.S. at 200-201. Similarly, in *Frank v. Minnesota Newspaper Ass’n*, 490 U.S. 225 (1989) (per curiam), in light of a concession by the appellant government officials, the plaintiff—appellee in this Court—“state[d] its willingness to forgo any further claim to the * * * relief sought in its complaint.” *Id.* at 227. Concluding that the case was moot, the Court vacated the judgment below and remanded with directions to dismiss. *Ibid.* (citing *Munsingwear*). See also *Webster v. Reproductive Health Services*, 492 U.S. 490, 512-513 (1989) (*Munsingwear* treatment in response to withdrawal by plaintiffs/appellees of request for relief in light of appellant’s legal position); *Gray v. Board of Trustees*, 342 U.S. 517, 518 (1952) (per curiam) (similar treatment where action of appellee mooted controversy); *Commercial Cable Co. v. Burleson*, 250 U.S. 360, 362 (1919) (same); see also *Board of Governors of Federal Reserve System v. Security Bancorp*, 454 U.S. 1118 (1981) (*Munsingwear* treatment where respondent’s actions mooted application for permission to acquire bank) (see 81-176 Pet. at 10-12); *DeFunis v. Odegaard*, 416 U.S. 312 (1974) (per curiam) (vacating judgment

of state supreme court after case was rendered moot by action of respondent).¹⁴

In sum, this Court's decisions do not support respondent's contention that *Munsingwear* is inapplicable when mootness is caused by a mutual agreement of the parties. Rather, those decisions strongly support the conclusion that a court of appeals' judgment should be vacated if the case is rendered moot by settlement after this Court grants a petition for a writ of certiorari, but before it decides the case.¹⁵

¹⁴ In the cases cited in the text, a case before the Court became moot because of unilateral action by the party that prevailed in the lower court. On occasion, however, the Court appears to have followed a similar approach when a case became moot because of unilateral action by the party that lost below. See, e.g., *Weinstein v. Bradford*, 423 U.S. 147, 148-149 (1975) (per curiam); *Preiser v. Newkirk*, 422 U.S. 395, 399, 402-404 (1975); *Board of Regents v. New Left Education Project*, 414 U.S. 807 (1973). The propriety of vacatur in those cases is not clear. Compare 13A Charles Alan Wright et al., *Federal Practice and Procedure* § 3533.10, at 430-431 (2d ed. 1984) (discussing *Board of Regents* and arguing that *Munsingwear* treatment is appropriate in such cases), with, e.g., *Arthur v. Manch*, 12 F.3d 377, 381 (2d Cir. 1993) ("[T]he appellate court should not vacate the judgment below if the case has become moot due to the voluntary act of the losing party.") (quoting *Manufacturers Hanover Trust Co.*, 11 F.3d at 383).

In our view, the losing party below should not be able to obtain vacatur of an unfavorable judgment through unilateral action, at least in the absence of unusual circumstances, such as when the losing party complies involuntarily with a preliminary injunction, *Honig v. Students of California School for the Blind*, 471 U.S. 148, 148-149 (1985) (per curiam), or when a legislative enactment resolves the immediate controversy, *Bowen v. Kizer*, 485 U.S. 386, 387 (1988) (per curiam). Where such unusual circumstances are not present, the losing party's unilateral action functionally resembles a failure to appeal or a decision to withdraw an appeal. Such a determination to forgo a challenge to the judgment justifies leaving it in place as a binding determination of the rights of the parties. Because this case became moot through a mutual agreement of settlement, that problem is not present here.

¹⁵ This case, of course, involves only the propriety of vacating judicial judgments when appeals of those judgments are rendered moot by

B. Considerations Of Fairness And Public Policy Support A General Rule Of Vacatur In Cases That Become Moot As A Result Of Settlement While Pending On Appeal Or Certiorari

Respondent contends (Resp. Reply 2) that considerations of judicial economy counsel against vacatur when a pending case is rendered moot by voluntary settlement. In our view, however, the established practice of vacatur in that context strikes the proper balance between the interests in judicial economy and the strong considerations of policy and fairness that support the Court's consistent approach in this area.

1. A rule of vacatur furthers the judicial system's important interest in voluntary settlement of disputes

Our legal system strongly favors voluntary resolution of disputes, which serves not only the private interests of the

settlement. Vacating an administrative decision presents considerably different considerations. Thus, although the Court has applied *Munsingwear* to an agency adjudication that became moot through the withdrawal of a request for administrative action while judicial review was pending, see *A.L. Mechling Barge Lines, Inc. v. United States*, 368 U.S. 324, 329 (1961), we believe that a different result is called for when the private parties affected by an agency ruling settle their differences and seek to have the agency's ruling vacated without the consent of the agency. In that setting, the agency itself is generally a party to the litigation as well, and its absence from the settlement agreement therefore ordinarily would prevent the case from being moot. The agency has an independent regulatory interest in its order, both with respect to the immediate parties and with respect to third parties who are not before the court but might be guided by the reasoning in the agency's order. Moreover, agencies are not constrained by the case-or-controversy requirement of Article III, so the mootness concerns underlying the *Munsingwear* doctrine have less force in that context. See generally *Radiofone, Inc. v. FCC*, 759 F.2d 936, 940-941 (D.C. Cir. 1985) (opinion of Scalia, J.); Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 54-64.

parties themselves, but also important public interests. *Marek v. Chesny*, 473 U.S. 1, 10 (1985); *Williams v. First National Bank*, 216 U.S. 582, 595 (1910); Note, *Avoiding Issue Preclusion by Settlement Conditioned upon the Vacatur of Entered Judgments*, 96 Yale L.J. 860, 866 n.41 (1987) [hereinafter Note, *Avoiding Issue Preclusion*]; Note, *Settlement Pending Appeal: An Argument for Vacatur*, 58 Fordham L. Rev. 233, 236 & nn.18 & 21, 242 (1989) [hereinafter Note, *Settlement Pending Appeal*] (collecting authorities). First, settlement serves the interests of judicial economy and efficiency by eliminating the necessity for further judicial consideration of the merits of the settled case. See, e.g., *Federal Data Corp. v. SMS Data Products Group, Inc.*, 819 F.2d 277, 280 (Fed. Cir. 1987) (to the extent that it prevents settlement, precluding vacatur "is wasteful of the resources of the judiciary"); Note, *Avoiding Issue Preclusion*, 96 Yale L.J. at 866-867. That interest has as much force when cases settle in this Court as it does when they settle in a trial court before judgment. Settlement eliminates the need for this Court to expend its scarce resources to resolve the questions raised by the case, as well as the need for the lower courts to conduct any further proceedings (including, in many cases, a trial) that could be necessary on remand.

Second, settlement promotes economic efficiency by capping litigation costs and permitting the parties to devote their resources and attention to more productive endeavors. See Note, *Avoiding Issue Preclusion*, 96 Yale L.J. at 867; Note, *Settlement Pending Appeal*, 58 Fordham L. Rev. at 239. In addition, settlement serves both public and private interests in the just resolution of disputes: "One of the fundamental principles of judicial administration is that, in most cases, the absolute result of a trial is not as high a quality of justice as is the freely negotiated, give a little, take a little settlement." Hubert L. Will et al., *The Role of the Judge in the Settlement Process*, 75 F.R.D. 203, 203 (1976); see *Chemetron Corp. v.*

Business Funds, Inc., 682 F.2d 1149, 1202 n.5 (5th Cir. 1982) (Reavley, J., dissenting), vacated and remanded, 460 U.S. 1007 (1983); Note, *Settlement Pending Appeal*, 58 Fordham L. Rev. at 236.

A general rule of vacatur upon settlement furthers those important interests by eliminating significant disincentives to settlement while a case is pending on appellate review (including review on writ of certiorari in this Court).¹⁶ Often it would be difficult or impossible to achieve a settlement if the judgment of the lower court would not thereafter be vacated. In cases in which the losing party has a strong interest in avoiding the preclusive effect of the judgment below¹⁷ or in eliminating its precedential force,¹⁸ that party might be

¹⁶ See *Nestle Co.*, 756 F.2d at 282; *Long Island Lighting Co.*, 888 F.2d at 234 n.4; Note, *Settlement Pending Appeal*, 58 Fordham L. Rev. at 242-243; Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 36-37.

¹⁷ We agree with the prevailing view that a judgment that has been vacated generally has no res judicata or collateral estoppel effect. See *Munsingwear*, 340 U.S. at 39-40; *Pontarelli Limousine, Inc. v. City of Chicago*, 929 F.2d 339, 340 (7th Cir. 1991); *Savidge v. Fincannon*, 836 F.2d 898, 906 & n.33 (5th Cir. 1988); *No East-West Highway Committee, Inc. v. Chandler*, 767 F.2d 21, 24 (1st Cir. 1985); *Dodrill v. Ludit*, 764 F.2d 442, 444 (6th Cir. 1985); *Quarles v. Sager*, 687 F.2d 344, 346 (11th Cir. 1982); 18 Charles Alan Wright et al., *Federal Practice and Procedure* § 4432, at 302 & n.18 (1981); 1B James Wm. Moore et al., *Moore's Federal Practice* ¶ 0.416[2], at III-314 (2d ed. 1993). But see *Bates v. Union Oil Co.*, 944 F.2d 647 (9th Cir. 1991), cert. denied, 112 S. Ct. 1761 (1992); *Chemetron Corp.*, 682 F.2d at 1187-1192.

¹⁸ Most courts that have considered the question have concluded that vacatur also deprives the lower court's judgment of its precedential effect. See, e.g., *County of Los Angeles v. Davis*, 440 U.S. 625, 634 n.6 (1979); *Martinez v. Winner*, 800 F.2d 230, 231 (10th Cir. 1986); *DHL Corp. v. CAB*, 659 F.2d 941, 944 n.4 (9th Cir. 1981); *Marshall v. Whittaker Corp.*, 610 F.2d 1141, 1145 (3d Cir. 1979); Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 95 & n.399 (collecting authorities). But see *United States v. Articles of Drug Consisting of 203 Paper Bags*, 818 F.2d 569, 572 (7th Cir. 1987). Of course, a decision that has been vacated still may have persuasive value

unwilling to forgo further appellate review if vacatur is unavailable (especially if the party believes it would prevail on such review). That concern is particularly strong in cases involving the government and other institutional litigants, which often are more interested in the precedential effect of a decision than in the details of the particular case. See Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 35 n.130. Thus, a general rule of vacatur when cases become moot through settlement encourages the voluntary resolution of disputes.¹⁹

based on the force of its legal analysis. See *County of Los Angeles*, 440 U.S. at 646 n.10 (Powell, J., dissenting); Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 100 & n.417.

¹⁹ At least one court has suggested that the practice of granting vacatur when cases settle on appeal will encourage parties to delay settlement until after trial, secure in the knowledge that vacatur will be available if the court enters an unfavorable judgment. *In re Memorial Hospital*, 862 F.2d at 1302; see Jill E. Fisch, *Rewriting History: The Propriety of Eradicating Prior Decisional Law Through Settlement and Vacatur*, 76 Cornell L. Rev. 589, 632-642 (1991) (economic model discussing impact on settlement decisions of possibility of vacatur). In our view, that concern is greatly overstated. The cases in which parties are most likely to view vacatur as potentially valuable are those "in which the legal or factual issues are sufficiently complex that it is difficult to predict the outcome of the litigation." *Id.* at 637 n.239. It is in precisely such cases, however, that "[a] pretrial settlement at a value that both parties view as reasonable may be impossible to achieve, given the substantial differences in the parties' expectations of the litigation outcome." *Ibid.*; see also Peter H. Schuck, *The Role of Judges in Settling Complex Cases: The Agent Orange Example*, 53 U. Chi. L. Rev. 337, 338-340 (1986) (summarizing literature suggesting that it is difficult to settle close cases); George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. Legal Stud. 1, 14-16 (1984) (economic model suggesting that it is difficult for parties to settle close cases).

Moreover, any concern about the effect that a rule of vacatur might have on pre-trial settlement would be overshadowed in most cases by the very real costs imposed on parties that choose to litigate unsuccessfully rather

By contrast, denying vacatur when parties settle cases that are pending on appeal undoubtedly would lead to additional litigation: Some parties, even if they could reach mutually agreeable settlement terms, would not be able to resolve their dispute voluntarily because of continuing concerns about the effects of the outstanding lower-court judgment. Indeed, as Judge Easterbrook has acknowledged, in a court that refuses to permit vacatur upon settlement, there is simply "no answer that will satisfy" a litigant that is unable to consummate an otherwise satisfactory settlement because of the unavailability of vacatur. See *In re Memorial Hospital, Inc.*, 862 F.2d 1299, 1303 (7th Cir. 1988).²⁰ In short, denying vacatur upon

than settle before judgment is entered by the district court. Litigation is expensive, and unfavorable judgments often result in damaging publicity that cannot be eliminated by subsequent vacatur. Also, the entry of an unfavorable judgment tends to increase dramatically the price of settlement for the losing party, because it significantly lessens that party's chance of eventual success in the courts. In the great run of cases, those incentives to settle are likely to be much more significant than any consideration arising from the possibility that the party later might be able to secure vacatur of any adverse judgment in connection with a settlement of the dispute. See also Greenbaum, *supra* note 6, 17 U.C. Davis L. Rev. at 37 ("[I]n all probability few litigants would appeal solely to make [vacatur] a portion of the settlement agenda.").

²⁰ As one leading treatise observes, "[i]t is particularly daunting to contemplate that even after the parties have preferred to surrender the opportunity for appellate review as a matter of right in order to achieve the certainty and economy of settlement, they can do so only if they are willing to submit to nonmutual issue preclusion in litigation with nonparties." 13A Charles Alan Wright et al., *Federal Practice and Procedure* § 3533.10, at 307 n.22 (Supp. 1994). In an attempt to respond to that concern, the Seventh Circuit has suggested that "[i]f parties want to avoid stare decisis and preclusive effects, they need only settle before the district court renders a decision, an outcome our approach encourages." *In re Memorial Hospital*, 862 F.2d at 1302. As explained above (see note 19, *supra*), however, it frequently is impracticable for the parties to settle at such an early stage,

settlement would frustrate important interests in fairness and judicial economy.

2. *The public interest in the judicial system and its decisions does not override the interests favoring settlement that are furthered by a rule of vacatur*

Respondent argues that a rule favoring vacatur of a judgment that is rendered moot by a settlement “would constitute a waste of judicial resources and serve no benefit.” Resp. Reply 2.²¹ We disagree.

a. First, it is an exercise in speculation to ground a rule that predicates denial of vacatur on the possibility that the precedential value of the decision below will benefit the public in the future. On the one hand, the benefits of leaving the decision in place are dubious. Because the vacatur issue before the Court here arises only in a case in which the Court has already granted a petition for a writ of certiorari but has not yet decided the case on the merits, there ordinarily will be

especially in complex litigation in which it may be difficult to evaluate the legal and factual issues at an early stage.

²¹ Several of the courts that have rejected vacatur when a case becomes moot by settlement have relied on the same point. *Clarendon Ltd.*, 936 F.2d at 129; *In re United States*, 927 F.2d at 628; *In re Memorial Hospital*, 862 F.2d at 1302-1303. Although the Seventh Circuit in particular also has relied on the interest in preserving the preclusive effects of the judgment, *id.* at 1303, respondent does not rely heavily on that point, perhaps because of the limited likelihood that the judgment of the court of appeals in this case will have significant preclusive effect. In any event, for the reasons set forth at pages 19-25 of our amicus brief in *Kaisha* (No. 92-1123), we do not think that the possible preclusive effects of a judgment in future cases offer a sufficient basis to deny vacatur following settlement of a pending dispute. We have provided a copy of our *Kaisha* brief to counsel for the parties.

a significant possibility that the decision below is incorrect;²² the public gains little or no benefit from a rule that gives such a decision continuing precedential force.²³ Furthermore, even if the decision below is correct, it will rarely be clear that its precedential value will be significant as a practical matter; it is notoriously difficult to evaluate the extent to which any particular judicial opinion will provide significant guidance in the resolution of future disputes even within the jurisdiction of the court that issued it. By contrast, for the reasons discussed above, the benefits of vacating a lower-court judgment following settlement are immediate and certain: Vacatur lessens the burden on the Court and promotes resolution of disputes in a manner more likely to be acceptable to both parties.

More fundamentally, a rule that elevates the possible effect of a lower-court opinion on hypothetical future cases over the interest that vacatur serves in promoting the voluntary resolution of a live dispute actually pending before the Court ignores the central role of an Article III court: resolving concrete cases and controversies between parties. “[T]he purpose for which civil courts have been established” is “the conclusive resolution of disputes within their jurisdictions,” *Montana v. United States*, 440 U.S. 147, 153 (1979), and “[i]n all civil litigation, the judicial decree is not the end but the

²² See, e.g., *The Supreme Court—Leading Cases*, 107 Harv. L. Rev. 144, 376 (1993) (Court affirmed only 36.8% of cases reviewed on certiorari during 1992 Term in which Court issued full opinions).

²³ For several reasons, the interests in stability that precedents usually further are not likely to be enhanced significantly by precedents as to which this Court has granted review. First, when those precedents are inconsistent with the decisions of other courts of appeals, they will exacerbate the problems associated with a lack of geographical uniformity. Second, even when there is not a conflict in the circuits, this Court’s willingness to grant plenary review is likely to cast sufficient doubt on the correctness of the decision to encourage litigation challenging the precedent.

means," *Hewitt v. Helms*, 482 U.S. 755, 761 (1987). Thus, "litigation exists to resolve the parties' genuine grievances; opinions are byproducts." *Bethune Plaza, Inc. v. Lumpkin*, 863 F.2d 525, 531 (7th Cir. 1988); see *Alliance To End Repression v. City of Chicago*, 820 F.2d 873, 876 (7th Cir. 1987); cf. *California v. Rooney*, 483 U.S. 307, 311 (1987) (per curiam) ("This Court 'reviews judgments, not statements in opinions.'") (quoting *Black v. Cutter Laboratories*, 351 U.S. 292, 297 (1956)). As Judge Winter has explained, it is inappropriate to rely on "the plight of hypothetical future defendants facing hypothetical future lawsuits" to justify "force[ing] [the appellees in an existing case] to bear the costs and risks of further litigation." *Nestle Co.*, 756 F.2d at 284. In sum, it is not appropriate to give controlling weight to the abstract and secondary public interest in the opinions of the lower federal courts.²⁴

b. Nor should the rule be limited to cases in which both parties seek vacatur of the lower court's decision pursuant to the settlement agreement. To be sure, it is especially perverse for a court to rely on the interests of persons who are not presently involved in the dispute within the court's jurisdiction as a basis for refusing to accept the terms of a settlement (including vacatur) agreed to by all the parties before the court. 13A Charles Alan Wright et al., *Federal*

²⁴ Vacatur upon settlement may be inappropriate when the judicial system itself has a distinct and legitimate interest in preserving the judgment below, as when the judgment involves contempt of court or otherwise implicates the authority of the courts, rather than the more generalized public interest in the precedential or preclusive value of judicial decisions in cases involving other parties. See *In re Memorial Hospital*, 862 F.2d at 1302-1303. In the contempt situation, for example, the court may be in a position analogous to that of a party to a case that has not joined in a settlement entered into by the other parties. Cf. note 15, *supra* (arguing that considerations favoring vacatur are diminished when private parties attempt to resolve a dispute regarding the decision of an administrative agency).

Practice and Procedure § 3533.10, at 307 n.22 (Supp. 1994). But the interests favoring settlement that support the rule of vacatur suggest that the same result should follow even if the party that prevailed in the lower court does not agree to vacatur.

The situation will arise most pointedly in a case in which the parties can agree upon a settlement of their underlying dispute, so that no live dispute would remain for decision, but the party that lost in the lower court is unwilling to agree to the settlement if it leaves the judgment of the lower court in effect. Absent a rule of vacatur, the parties would not settle and the court would be called upon to expend its resources to resolve the dispute. The sole interest furthered by the failure of the settlement in that scenario is the posited interest of persons not before the court in the precedential or preclusive effects of the judgment.²⁵ But that interest is of relatively attenuated significance to an Article III court, whose jurisdiction is limited to "Cases" and "Controversies." Where the parties can terminate the dispute that justified the exercise of Article III jurisdiction, the system diserves the parties if it protracts the case by leaving in place the judgment that the parties have decided to abandon as the basis for resolving their

²⁵ If the settlement would have rendered the case truly moot, in the sense that it would have removed any likelihood that the dispute would recur between the parties, the party that prevailed in the lower court would not have any direct interest in the continuing force of the judgment. If a cognizable likelihood of a recurring dispute remains—and if it is likely to evade review—then of course the case would not be moot and vacatur therefore would be inappropriate. See 13A Charles Alan Wright et al., *Federal Practice and Procedure* § 3533.10, at 431 (2d ed. 1984) ("Any justified fear that the appellee may still need the protection of a judgment can be met by finding the case is not moot; that is the purpose of the elaborate rules governing voluntary discontinuance.").

dispute.²⁶ Accordingly, mootness occasioned by settlement justifies vacatur even if both of the parties do not seek that disposition.

II. IF THE COURT ADOPTS A RULE CALLING FOR CASE-BY-CASE CONSIDERATION, VACATUR IS APPROPRIATE IN THIS CASE

At least one court of appeals has adopted a rule under which the court considers on an ad hoc basis whether vacatur is appropriate, based on a balancing of “the competing values of finality of judgment and right to relitigation of unreviewed disputes.” *Ringsby Truck Lines, Inc. v. Western Conference of Teamsters*, 686 F.2d 720, 722 (9th Cir. 1982). If the Court adopts such an ad hoc approach, we believe that two circumstances indicate that vacatur would be appropriate in this case.²⁷

²⁶ Logically, it is possible that a rule of vacatur would hinder settlement in cases in which the party that prevailed below is unwilling to accept a settlement that brings about vacatur of the judgment. As a general rule, however, vacatur is less likely to be of great concern to the party that prevailed than a denial of vacatur will be to the party that lost, because vacatur simply returns the parties to the status quo ante—with no judgment and no judicial opinion on the legal questions—while a denial of vacatur leaves one party burdened with a legal decision the precedential (and preclusive) import of which may be quite significant.

²⁷ Our amicus brief in *Kaisha* suggested (at 27-28) that if the Court rejected the general rule of vacatur we urged, the Court should adopt a rule under which a court presented with a joint request for vacatur would consider the request in a manner similar to the way in which courts review proposed consent decrees. That approach would not be directly helpful to the Court’s resolution of the vacatur issue in this case, because the parties have not submitted to the Court a joint request for action. We note, however, that the parties did submit their consensual plan for reorganization to the bankruptcy court, which approved the plan. Vacatur is especially appropriate in light of that disposition of the underlying dispute.

A. This is not a case in which “litigants who [we]re dissatisfied with the decision of the [lower] court [attempted] to have [it] wiped from the books by merely filing an appeal, then complying with the order or judgment below and petitioning for a vacatur,” *In re United States*, 927 F.2d 626, 628 (D.C. Cir. 1991) (internal quotation marks omitted). When parties settle after this Court has granted a petition for a writ of certiorari, there can be little doubt that the petitioner’s challenge to the judgment of the lower court was a substantial one that raised important questions of federal law. It is unlikely that parties frequently will adopt—or succeed in pursuing—a tactic of attempting to cause this Court to grant certiorari, solely with a view to settling the case and thereby removing the adverse precedential effect of the decision of a court of appeals.

Moreover, the terms of the settlement at issue here make it clear that this is not a case in which the party that lost below has rendered the case moot by relinquishing its efforts to overturn the lower court’s decision. Petitioner responsibly accepted an offer of settlement in which respondent retreated dramatically from the position upheld by the lower courts—an offer that as a practical matter afforded petitioner treatment similar to that which it would have obtained if it had prevailed in this Court. Under the terms of the plan initially approved by the lower courts, petitioner had a secured claim for \$3,200,000, representing the fair market value of the collateral as determined by the bankruptcy court. Although the plan technically provided that the secured claim would be paid in full, the plan for repayment was not favorable: it provided for monthly payments of interest only, and then a balloon payment of the principal balance 32 months after implementation of the plan. J.A. 11. Furthermore, because the obligations of the reorganized debtor to make those payments were secured only by the preexisting collateral, any decrease in the value of the collateral during the 32-month period would have diminished considerably the likelihood of petitioner’s

receiving full payment of its claim. If petitioner had prevailed in this Court, the courts could not have approved that plan. Petitioner then would have been entitled to insist on an order lifting the automatic bankruptcy stay, which would have allowed petitioner to foreclose on the collateral and receive its full value at that time.

In contrast, the Third Amended Plan of Reorganization implemented pursuant to the parties' settlement gives petitioner substantial assurances that its secured claim will be paid in full.²⁸ To induce petitioner's voluntary agreement to refrain from foreclosing at this time, respondent and its owners agreed to contribute substantial additional collateral, effectively ensuring that petitioner in fact will be paid in full even if the reorganization is unsuccessful. Specifically, Paragraph 5.3.1.1 of the plan grants petitioner an express personal guaranty for the entire amount of the secured claim from both H.F. Magnuson and Lloyd Andrews (two of the principals of respondent). Third Amended Plan of Reorganization at 11. That Paragraph also provides that petitioner is to receive a first lien on Lloyd Andrews's personal residence and a second lien on a parcel of land adjacent to the existing shopping center. *Id.* at 10-11. Finally, respondent's principals are obligated to provide still more collateral if appraisals performed by persons selected by petitioner do not provide "evidence to [petitioner's] satisfaction" that the total value of the collateral exceeds the outstanding balance of the secured claim by a significant amount. *Id.* at 12-13.²⁹

²⁸ The Third Amended Plan of Reorganization appears as Exhibit B to the Memorandum of Respondent Suggesting that the Case Is Moot.

²⁹ Specifically, the ratio of the outstanding secured claim to the total value of the collateral must be no greater than 65%. Third Amended Plan of Reorganization at 12.

Two other features of the Third Amended Plan also improved petitioner's position considerably. First, although the plan initially approved by the lower courts provided for petitioner to receive interest at a rate capped at

In sum, the significant concessions by respondent reflected in the settlement suggest that it is inappropriate to view this as a case in which a petitioner retreated from its opposition to the lower court's judgment and seeks vacatur from this Court, even though the petitioner was unable to persuade the respondent to retreat from its position. As a practical matter, it is more accurate to view this as a case in which the respondent was unwilling to defend the judgment of the court of appeals and therefore entered into a settlement that gives up the greater part of the benefits it would have received under that judgment. Those circumstances suggest that vacatur would be especially appropriate. Cf. pages 15-16, *supra* (discussing this Court's practice of vacating lower-court judgments when a case becomes moot because of unilateral action by the party that prevailed in the lower court).

B. The importance of resolving a conflict among appellate decisions also counsels in favor of vacating the unreviewable judgment below. It appears that the decision in this case is the only court of appeals ruling that has expressly affirmed the new-value exception to the absolute priority rule since this Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).³⁰ Accordingly, an order vacating

7% per annum (J.A. 11), the Third Amended Plan provides (at 9-10) for an interest rate of 8.75% per annum. Second, although the plan initially approved by the lower courts provided for monthly payments of interest only (J.A. 11), the Third Amended Plan provides (at 10) for monthly payments in an amount that would amortize the entire debt over a 25-year period. The amortizing payments increase the security of the lender by decreasing the outstanding balance of the loan over time, and by increasing the debtor's equity in the property, which increases the debtor's incentive to care for the property.

³⁰ See Pet. 13-16 (discussing the decisions of the lower courts). Neither of the court of appeals decisions on which respondent relies (Br. in Opp. 17-18) as supporting the new-value exception included a square holding that the exception survives this Court's decision in *Ahlers*. *In re Anderson*, 913

the decision of the court of appeals would remove the circuit conflict that called for immediate action by this Court and leave the questions open for further consideration by all of the courts of appeals, including the Ninth Circuit. If another court of appeals hereafter should decide this issue in a way that creates a circuit conflict, the Court can review the matter at that time. The benefits of further consideration by the lower courts, unconstrained by the unreviewable decision in this case, counsel in favor of vacating the judgment below.

CONCLUSION

The judgment of the court of appeals should be vacated and the case should be remanded with directions to dismiss petitioner's motion for relief from the automatic stay.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

EDWIN S. KNEEDLER
Deputy Solicitor General

RONALD J. MANN
Assistant to the Solicitor General

LEONARD SCHAITMAN
JOHN P. SCHNITKER
Attorneys

MAY 1994

F.2d 530 (8th Cir. 1990), in fact affirmed a bankruptcy court order rejecting a debtor's reliance on the new-value exception; the court merely stated in dictum that "[t]he district court recognized the continuing validity of the 'new value' exception to the absolute priority rule." *Id.* at 532. *In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986), predicated *Ahlers* by more than a year.

No. 93-714

Supreme Court U.S.
FILED
FEB 22 1994
OFFICE OF THE CLERK

In The
Supreme Court of the United States
October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,

Petitioner,

v.

BONNER MALL PARTNERSHIP,

Respondent.

On Writ Of Certiorari To The
United States Court Of Appeals
For The Ninth Circuit

**AMICUS CURIAE BRIEF OF CHARLES W. ADAMS
IN SUPPORT OF NEITHER PARTY**

CHARLES W. ADAMS
Professor of Law
The University of Tulsa College
of Law
3120 East Fourth Place
Tulsa, OK 74104
(918) 631-2437

Amicus Curiae

TABLE OF CONTENTS

	Page
Interest of Amicus Curiae	1
Summary of Argument	1
Argument	2
I. The Purpose of Chapter 11.....	2
II. The Source of the Capital Contribution....	4
III. The Form of the Capital Contribution	7
IV. The Amount of the Capital Contribution... 11	11
V. Application to the Facts of This Case..... 17	17
Conclusion	20

TABLE OF AUTHORITIES

	Page
CASES	
<i>Butner v. United States</i> , 440 U.S. 48 (1979)	11
<i>Case v. Los Angeles Lumber Co.</i> , 308 U.S. 106 (1939). . <i>passim</i>	
<i>In re Bonner Mall Partnership</i> , 2 F.3d 899 (9th Cir. 1993).....	18
<i>In re Mobile Steel Co.</i> , 563 F.2d 692 (5th Cir. 1977)	17
<i>Kham & Nate's Shoes No. 2, Inc. v. First Bank</i> , 908 F.2d 1351 (7th Cir. 1990).....	8, 9, 11
<i>Northern Pacific Railway v. Boyd</i> , 228 U.S. 482 (1913).....	6
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988).....	7, 9
STATUTES AND OTHER AUTHORITIES	
11 U.S.C. § 1129.....	2, 15
12 U.S.C. § 24.....	5
Idaho Const. art. XI, § 9.....	19
Idaho Code §§ 30-1-18, 30-1-21.....	18
Idaho Code § 30-1-19.....	19
Regulation Y, 12 C.F.R. § 225.22.....	5
1 Model Business Corp. Act Ann. § 6.21 (3d ed. 1989).....	9, 10, 11
1 Model Business Corp. Act Ann. § 19 (2d ed. 1971).....	9, 10
79 Fed. Reserve Bull. A37 (Sep. 1993).....	19

TABLE OF AUTHORITIES - Continued

	Page
Charles W. Adams, <i>An Economic Justification for Corporate Reorganizations</i>, 20 Hofstra L. Rev. 117 (1991)	1, 4
Frederick K. Beutel & Milton R. Schroeder, <i>Bank Officer's Handbook of Commercial Banking Law</i> §§ 4-30, 5-30 (5th ed. 1982)	5
Douglas G. Baird, <i>The Initiation Problem in Bank- ruptcy</i>, 11 Int'l. Rev. L. & Econ. 223 (1991).....	6
Milton Harris & Artur Raviv, <i>The Theory of Capital Structure</i>, 46 J. Fin. 297 (1991)	16
John B. Levy, <i>Regulations Prompt Higher Minimum Spreads</i>, 35 Nat'l Real Estate Investor 24 (Mar. 1993).....	19
Lynn M. LoPucki & William C. Whitford, <i>Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies</i>, 78 Cornell L. Rev. 597 (1993)	16
Bruce A. Markell, <i>Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations</i>, 44 Stan. L. Rev. 69 (1991)	12

Letters from the parties consenting to the filing of this amicus curiae brief have been filed with the Clerk.

INTEREST OF AMICUS CURIAE

I am not representing a client, and the views expressed in this brief are my own. I have no monetary interest in this or any other bankruptcy case. Aside from wishing to assist the Court, my interests in this case are entirely academic. I am a Professor of Law at The University of Tulsa College of Law, where I have taught courses in creditors' rights and bankruptcy. I am the author of *An Economic Justification for Corporate Reorganizations*, 20 Hofstra L. Rev. 117 (1991). I had completed a forthcoming article dealing with capital contributions in Chapter 11 reorganizations when the Court granted *certiorari* in this case.

SUMMARY OF ARGUMENT

This brief supports the Respondent's position that the Court should recognize a new capital exception to the absolute priority rule. However, it is opposed to the Respondent's plan of reorganization because the plan does not appear to provide an adequate equity cushion in the debtor's capital structure following reorganization. Consequently, this brief is aligned with neither party.

The purpose of a Chapter 11 reorganization is to repair an insolvent company's dysfunctional capital structure. It should not matter whether the new capital

that an insolvent company needs for a successful reorganization comes from its creditors, outside investors, or its former owners. What is critical to the reorganization is the substance (i.e., the form and amount) of the new capital contribution, rather than its source. In addition to recognizing the new capital exception, the Court should clarify the size of the capital contribution that is required.

The prevailing standard from *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 121-22 (1939), is unworkable. While superficially plausible, the *Los Angeles Lumber* standard turns out on closer analysis to be merely a tautology. It should be replaced by a standard requiring an investment of sufficient new capital that the reorganized company will have a capital structure solid enough to withstand future adversity without failing again. This standard derives from the "feasibility requirement" in 11 U.S.C. § 1129(a)(11). Section 1129(a)(11) prescribes that a bankruptcy court shall confirm a reorganization plan only if it "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor."

ARGUMENT

I. The Purpose of Chapter 11

A bankruptcy reorganization is a process for restoring financial health to an insolvent business through an adjustment of its capital structure. Generally, the adjustment involves the discharge of some debt and the infusion of new capital from either outside investors, the company's creditors, or its owners.

A business normally is financed partly through equity and partly through debt. Some equity is essential in a company's capital structure to capture the residual interest in its future earnings. Most companies also have substantial levels of debt financing. Besides offering a tax benefit, debt in a company's capital structure provides leverage to owners, enabling them to earn a higher expected return, though at greater risk.

Excessive debt, however, produces a risk of default and a possible conflict of interest between the company's owners and its creditors. A conflict of interest may arise because the owners are entitled to the profits if the business succeeds, while the maximum return for the creditors is the stated rate of interest. In a company where most of the capital structure is debt with its owners having only a small amount of equity invested, the owners will have an incentive for excessive risk-taking. The owners have everything to gain if a risky venture succeeds, and nothing but their limited equity to lose if it fails. The creditors, on the other hand, will continue to earn only their fixed interest payments if the venture is successful, while they risk nonpayment of the loan principal if it fails.

The risk of default and the potential conflict of interest associated with a leveraged capital structure are normally held in check by the maintenance of a suitable equity cushion. An equity cushion represents the owners' stake in the enterprise, and the presence of a substantial equity cushion insures that most of the risk is borne by the owners, rather than the creditors.

An insolvent company has a pathological capital structure. Because liabilities already exceed asset value, an insolvent company's owners have nothing more to lose from further operating losses. Rather than maximizing the expected return from operations, the owners' primary concern will be to have the business earn a sufficient return so that it can become solvent again. Because owners of an insolvent company bear none of the downside risk, they will favor risky ventures with the potential for large gains over others with more predictable, but smaller, gains. Until the business achieves solvency, moderate gains will benefit only the creditors and not the owners.

Unfortunately, both the creditors and owners of an insolvent business lack incentives for maximizing its long term interests. Insolvency generates destructive conflicts of interests between the company's owners and creditors, with the owners seeking to have the business take excessive risks and the creditors trying to collect as much on their claims as they can through seizure of the company's assets. A company cannot operate effectively until these conflicts are resolved. It is the resolution of these conflicts through the restoration of a sound capital structure that is the fundamental purpose of the bankruptcy reorganization process. Charles W. Adams, *An Economic Justification for Corporate Reorganizations*, 20 Hofstra L. Rev. 117, 117-38, 157-58 (1991).

II. The Source of the Capital Contribution

There are only three potential sources of capital for an equity cushion in a reorganized company: the company's creditors, outside investors, and its existing owners.

First, the company's creditors may provide the necessary capital through a conversion of some of their debt into equity. A satisfactory capital structure can be restored by discharging part of the debt (the portion above the company's going concern value) converting some debt to equity to create an equity cushion, and allowing the remainder to continue as debt in the reorganized company. A major disadvantage of this approach to reorganization is that it may not be feasible for some creditors to become equity owners of the reorganized business. Banks, for example, are a major source of debt financing, and the Glass-Steagall Act, 12 U.S.C. § 24 (Seventh), imposes significant restrictions on their ownership of common stock. See Regulation Y, 12 C.F.R. § 225.22(c)(1)(i) (bank holding companies may hold voting securities that are acquired in the ordinary course of collecting a debt if they are divested within two years of acquisition); Frederick K. Beutel & Milton R. Schroeder, *Bank Officer's Handbook of Commercial Banking Law* §§ 4-30, 5-30 (5th ed. 1982).

Outside investors are an alternative source of new capital for the equity cushion. Again, the portion of the debt above the company's going concern value will have to be discharged with the remainder continuing as debt in the reorganized company. In return for their new capital contributions, the outside investors receive ownership of the reorganized company, and their ownership interests constitute the equity cushion. A major disadvantage to this approach is that it may be difficult to find outside investors willing to contribute capital to an insolvent company.

A significant disadvantage to obtaining equity cushion capital from either creditors or outside investors is that these approaches offer no benefit to the existing owners of the insolvent company, who lose control in the reorganized company. In many cases, the existing owners may be familiar with the business operations and have been involved in managing the company; thus, the reorganized company may be disadvantaged by the loss of their association with it.

A more serious problem with these approaches is that they offer the owners no reason to initiate the reorganization process. If the company's owners have no incentive to file a reorganization proceeding, they will be inclined to seek delay and to take increasingly risky gambles hoping that solvency will be restored eventually through some miracle. This is likely to lead to further financial deterioration, to the point where recovery is no longer possible. In theory, the insolvent company's creditors can file involuntary Chapter 11 proceedings if the owners fail to do so. But in practice, creditors do not have ready access to the company's financial information, and initiating an involuntary proceeding is difficult and risky for them. See Douglas G. Baird, *The Initiation Problem in Bankruptcy*, 11 Int'l Rev. L. & Econ. 223 (1991).

An additional justification for allowing participation by the former owners in the reorganized company is that they may be the best source of new capital. See *Northern Pacific Railway v. Boyd*, 228 U.S. 482, 495 (1913). Unless the owners are allowed to provide new capital for the reorganizing company, the reorganization may fail and the creditors could wind up receiving less in liquidation than they would have under the plan. If the absolute priority

rule bars contributions of new capital from an insolvent company's owners, it could be detrimental to the interests of the very unsecured creditors it was designed to protect.

Contributions of new capital from an insolvent company's former owners should be encouraged, rather than barred. Accordingly, this Court should recognize the new capital exception to the absolute priority rule. At the same time, the Court should require the form and amount of the capital contributions to be sufficient to fulfill the purpose of the Chapter 11 reorganization process by restoring financial health to the reorganized company.

III. The Form of the Capital Contribution

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988), this Court addressed the form required for a capital contribution if the new capital exception were to be recognized. Following *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 121-22 (1939), the Court held that capital contributions would have to be in the form of "money or money's worth."

The reorganization plan in *Los Angeles Lumber* called for contributions from the reorganizing corporation's former shareholders that consisted merely of their "financial standing and influence in the community" and their providing "continuity of management." *Id.* at 122. The Court held that these intangibles were not adequate consideration for the issuance of stock in the reorganized corporation, saying: "On the facts of this case they cannot possibly be translated into money's worth reasonably

equivalent to the participation accorded the old stockholders. They have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities." *Id.* at 122-23 (footnote omitted).

The reorganization plan in *Ahlers* called for "yearly contributions of labor, experience, and expertise," 485 U.S. at 201, from the owners of a farm. As in *Los Angeles Lumber*, the Court decided that these contributions of future services were not sufficient to justify an exception from the absolute priority rule. It reasoned:

Viewed from the time of approval of the plan, respondents' promise of future services is intangible, inalienable, and in all likelihood, unenforceable. It "has no place in the asset column of the balance sheet of the new [entity]." *Los Angeles Lumber*, 308 U.S., at 122-23. Unlike "money or money's worth," a promise of future services cannot be exchanged in any market for something of value to the creditors *today*. In fact, no decision of this Court or any Court of Appeals, other than the decision below, has ever found a promise to contribute future labor, management, or expertise sufficient to qualify for the *Los Angeles Lumber* exception to the absolute priority rule.

Id. at 204 (emphasis in original) (footnote omitted).

In *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1362-63 (7th Cir. 1990), the Seventh Circuit confronted a type of capital contribution similar to one offered in the reorganization plan in this case: a shareholder guarantee of a loan to the reorganizing corporation. The plan of reorganization provided for the

corporation's former shareholders to retain ownership of the corporation in return for their guaranteeing new loans that would finance the reorganization. *Id.* at 1354.

Relying on *Ahlers* and *Los Angeles Lumber*, the Seventh Circuit ruled that the guarantees could not constitute new value for purposes of satisfying a new capital exception to the absolute priority rule. Judge Easterbrook's opinion for the court pointed out that guarantees are not balance-sheet assets; instead, guarantees are intangible, inalienable, and unenforceable, because there is no way for a corporation to prevent shareholders from revoking their guarantees or rendering them valueless by disposing of their assets. The court also noted that persons organizing a new corporation in Illinois could not issue stock to themselves in return for guarantees of loans, because Illinois law restricts the consideration for new shares to money, property, or past services. *Id.* at 1362.

The Seventh Circuit made a useful comparison in the *Kham & Nate's Shoes* decision between on the one hand, the problem of the form of new capital contributions in the corporate reorganization context, and on the other, the problem of "watered stock" and the form of capital contributions required as consideration for the issuance of stock under general corporate law. For many decades, the trend in corporate law has been in the direction of increasing liberalization of the form of allowed capital contributions. 1 Model Business Corp. Act Ann. § 6.21 history (3d ed. 1989); 1 Model Business Corp. Act Ann. § 19 comment (2d ed. 1971). The Model Business Corporation Act (2d ed. 1971) provided:

The consideration for the issuance of shares may be paid, in whole or in part, in money, in other property, tangible or intangible, or in labor or services performed for the corporation. . . .

Neither promissory notes nor future services shall constitute payment or part payment for the issuance of shares of a corporation.

1 Model Business Corp. Act Ann. § 19 (2d ed. 1971).

The Revised Model Business Corporation Act (3d ed. 1989) broadens the allowable consideration to "any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services performed, contracts for services to be performed, or other securities of the corporation." 1 Model Business Corp. Act Ann. § 6.21 (3d ed. 1989). The Official Comment to Section 6.21 explains:

Section 6.21(b) specifically validates contracts for future services (including promoters' services), promissory notes, or "any tangible or intangible property or benefit to the corporation," as consideration for the present issue of shares. . . . In the realities of commercial life, there is sometimes a need for the issuance of shares for contract rights or such intangible property or benefits. And, as a matter of business economics, contracts for future services, promissory notes, and intangible property or benefits often have value that is as real as the value of tangible property or past services, the only types of property that many older statutes permit as consideration for shares.

Whether intangible property should be a permissible form for a new capital contribution in a bankruptcy reorganization should depend on the applicable state corporate law. See *Butner v. United States*, 440 U.S. 48, 55 (1979) (in the absence of an overriding federal interest, property rights in bankruptcy proceedings should be determined by reference to state law). Thus, if the applicable state law would permit a promise of future services (as in *Ahlers*) or a shareholder guarantee (as in *Kham & Nate's Shoes* or this case) to constitute allowable consideration for the issuance of stock in a corporation, then these forms of intangible property should be permissible as capital contributions, whether they come from a former shareholder or an outside investor. Most states (including Idaho), however, continue to follow Section 19 of the Model Business Corporation Act (2d ed. 1971) and prohibit the issuance of shares in exchange for such forms of intangible property. See 1 Model Business Corp. Act Ann. § 6.21 annot. at 370-71 (3d ed. 1989) (listing states).

IV. The Amount of the Capital Contribution

The prevailing standard for the amount of the new capital contribution in a plan of reorganization comes from the following dictum in *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 122 (1939): "[T]he stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder." Because the shareholders' contribution in that case was not "in money or in money's worth," it was not in the proper form, and the Court did not decide whether it was "reasonably equivalent" to the value of the equity the shareholders were to receive under the plan. Thus, the

Court's statement concerning the amount of the new capital contribution was not part of the holding.

Although this standard appears reasonable, it provides no real guidance to courts, because it is a tautology. See Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 96-101 (1991). Under the absolute priority rule, all of an insolvent company's value must be allocated to its creditors; any debt in excess of its value as a going concern is discharged. When new capital is contributed, the *Los Angeles Lumber* dictum will be satisfied as a matter of course, because the only value not allocated to the creditors is the new capital contribution. As Professor Markell notes, rather than placing any limits on the new capital exception to the absolute priority rule, the *Los Angeles Lumber* standard "merely rephrases the . . . rule." *Id.* at 101.

In order to repair an insolvent company's capital structure in the course of the reorganization process, its liabilities must first be written down to the going concern value of the assets. At that point, the going concern value of the company's assets net of its liabilities is zero. The going concern value of the company's assets net of liabilities may not be greater than zero, because if it were, the creditors would be entitled to the excess as a result of the absolute priority rule. A contribution of new capital to the reorganizing company causes its going concern value net of its liabilities to increase precisely by the amount of the contribution. Since the contribution will always be equivalent to the resulting going concern value net of liabilities, the amount of the capital contribution that is required in the reorganization process cannot be determined from the company's going concern value.

The indeterminacy of the *Los Angeles Lumber* standard may be demonstrated with a numerical example. Consider the balance sheet of a company that initially has assets with a going concern value of \$1 million and liabilities of \$3 million. Writing down the liabilities to \$1 million (the going concern value of the assets) would yield a net going concern value of zero. If an owner or other investor were to make a capital contribution of as little as \$5,000 after the writing down of the liabilities, the going concern value of the company's assets after the contribution would be \$1,005,000 and its net going concern value would be \$5,000. This is illustrated below.

<i>Before Reorganization</i>			
Assets	\$1,000,000	Liabilities	\$3,000,000
		Equity	<u>-2,000,000</u>
Total	\$1,000,000		\$1,000,000

<i>After Reorganization</i>			
Assets	\$1,000,000	Liabilities	\$1,000,000
Shareholder Contribution	<u>5,000</u>	Equity	<u>5,000</u>
Total	\$1,005,000		\$1,005,000

An owner's contribution of new capital does not vanish when it is made; instead, it increases the going concern value of the reorganized company. The increase in going concern value resulting from the infusion of new capital may be even larger than the amount of the new capital contribution, and over time, the participation of former owners may contribute to the company's going

concern value, particularly if they are involved in the company's management or operations.

Since the *Los Angeles Lumber* standard is fundamentally unsound, it should be replaced with a better standard that is consistent with the purpose of the Chapter 11 reorganization process. The most appropriate criterion for the size of the new capital contribution is that it should be sufficient to provide an adequate equity cushion. The price that the new owners of a reorganized business should be required to pay for control following the reorganization is neither the going concern value (which will initially be zero if the company's assets are valued correctly and the absolute priority rule is applied) nor the amount of liabilities that are to be discharged. Instead, the price should be that the new owners must put up a sufficient stake in the enterprise to absorb any future losses that can reasonably be anticipated, thus reducing the risks to the creditors.

Absolute protection for a company's creditors is not attainable. No business is entirely risk free, and there is always some possibility of future losses to creditors that cannot be eliminated with any finite amount of equity capital. Although creditors cannot expect to receive absolute protection, they can be shielded from most risk of loss through the maintenance of an adequate cushion of equity. An adequate cushion of equity means the company's owners will have appropriate incentives to maximize the long term value of the company, whether the equity cushion comes from outside investors or from former owners. The equity cushion ought to be large enough, not only to keep the potential conflicts of interest between owners and creditors to a minimum, but also to absorb any fluctuations in earnings that can reasonably

be anticipated. Otherwise, there is too great a risk of another insolvency, and the reorganization will have been for naught.

To protect the company's existing and future creditors from a second insolvency, the "feasibility requirement" in section 1129(a)(11) of the Bankruptcy Code provides that a bankruptcy court should confirm a reorganization plan only if confirmation "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor." This requirement has long been a part of the law of bankruptcy reorganizations. To determine whether a plan satisfies the feasibility requirement, the courts normally look at whether there is a reasonable prospect for the reorganization plan to be successful. While the adequacy of a debtor's capital structure is often listed as one of the factors used in analyzing a plan's feasibility, the bankruptcy courts have tended to concentrate more on the accuracy of the plan's income projections than on the need for the owners of the reorganized company to have a significant stake in the enterprise.

The feasibility requirement cannot be satisfied if the reorganized business is so thinly capitalized that it is unable to withstand some future losses. The largest possible equity cushion would be provided by an all-equity capital structure, but most companies operate satisfactorily with substantial levels of debt. The presence of debt increases risk, but the reorganized company obtains offsetting benefits from the tax advantages and leverage that debt financing provides. And subject always to the stability of the expected earnings for the reorganized company, the risk of insolvency following reorganization can be

held to an acceptable level by maintaining an adequate equity cushion.

A variety of factors may potentially influence a company's capital structure. These include the company's profitability, the uniqueness of its products, the degree of specialization of its equipment and its employees, and the extent of equity ownership by its management. See Milton Harris & Artur Raviv, *The Theory of Capital Structure*, 46 J. Fin. 297, 337-40 (1991) (summarizing theoretical and empirical studies on the effect of these and other factors on a corporation's capital structure). However, the primary factor affecting a company's capital structure is generally the volatility of its earnings. A number of studies have shown, for example, that corporations in regulated industries, which tend to have stable earnings, have the highest proportions of debt, while pharmaceutical and electronics manufacturers, which tend to have volatile earnings, have the smallest proportions of debt. *Id.* at 333-35. Therefore, the capital structures of other companies in the same industry may provide a gauge for a bankruptcy court to use in evaluating the adequacy of a proposed equity cushion in a reorganization plan. Cf. Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 Cornell L. Rev. 597, 607-09 (1993) (companies emerging from reorganizations tend to have higher debt-to-equity ratios than companies of comparable size in the same businesses).

Although there may not be any precise formula for determining an ideal capital structure for a reorganized company, in many cases a bankruptcy court can be reasonably certain that a capital structure proposed in a plan under review is inadequate. For example, it is clear that a

business should not be allowed to emerge from the reorganization process without any equity cushion. For closer cases, the bankruptcy court may need expert testimony from a financial analyst concerning the adequacy of capitalization and possibly also from a lender as to the likelihood of the debtor being able to borrow the debt provided for in the plan from an informed outside source. See *In re Mobile Steel Co.*, 563 F.2d 692, 703 (5th Cir. 1977) (listing methods for determining the adequacy of capitalization in equitable subordination cases).

The adequacy of the capital contribution proposed in this case is addressed below.

V. Application to the Facts of This Case

In this case the debtor's primary asset is a shopping mall in Idaho, which the bankruptcy court valued at \$3.2 million. Its major liability is a loan of \$6.6 million secured by a deed of trust against the mall. The debtor's plan provides for repayment of the secured portion of the loan (\$3.2 million) 32 months after confirmation with interest payable monthly in the interim. Unsecured creditors with claims greater than \$1,000 will receive a *pro rata* distribution of 300,000 shares of preferred stock, which has a par value of \$1.00 per share and is convertible to a maximum of 300,000 shares of common stock upon repayment of the secured portion of the loan. The preferred shares will have a liquidation preference over the common stock. The debtor's six former partners together are to contribute cash of \$200,000 and will receive 2 million shares of common stock in return. In addition, the plan calls for the partners to subsidize any shortfall in working capital during the first 32 months after confirmation of the plan

and for five of the former partners to contribute a collateral trust mortgage on other property as a guarantee of the debts that are being assumed by the reorganized business. See *In re Bonner Mall Partnership*, 2 F.3d 899, 905 (9th Cir. 1993).

It is apparent that the reorganized corporation would be too thinly capitalized to satisfy the feasibility requirement. Even though the reorganized corporation would not be immediately insolvent if the plan were confirmed, the common shareholder's equity interest would be "under water" on account of the issuance of the 300,000 shares of \$1.00 par value preferred stock to the corporation's former unsecured creditors. The issuance of the preferred shares would therefore violate the stated capital requirements of applicable Idaho law. See Idaho Code §§ 30-1-18, 30-1-21 (1980) (prohibiting the issuance of shares for less than their par value). With only a \$200,000 equity cushion, the common shareholders would not be entitled to any profits until the \$100,000 impairment of capital resulting from issuance of the preferred stock was cured. Consequently there is a potential conflict of interest between the common and preferred shareholders built into the capital structure of the reorganized corporation.

The *Bonner Mall* plan is also deficient on account of the size of the equity cushion. There are a number of factors that affect the size of a real estate loan, but most lenders require at least a 75% loan to value ratio:

Since the beginning of the commercial mortgage business, lenders have imposed a 75% loan-to-value limit as being prudent. This real estate recession has unfortunately shown that even that level of leverage was too aggressive. As a result, a number of survey members are now

requiring that their commercial mortgages meet a 65% loan-to-value test or less.

John B. Levy, *Regulations Prompt Higher Minimum Spreads*, 35 Nat'l Real Estate Investor 24 (Mar. 1993). Cf. 79 Fed. Reserve Bull. A37 (Sep. 1993) (loan-to-value ratios for mortgages on new homes ranged from 74.8% to 79.5% between 1990 and June, 1993). An appropriate equity cushion for the secured creditor's \$3.2 million claim might therefore be in the neighborhood of \$1 million, instead of the \$200,000 called for in the reorganization plan.

The plan also calls for the former partners to subsidize any shortfall in working capital and to guarantee the payment of the reorganized corporations with a collateral trust mortgage. Depending on the circumstances, these guarantees might have sufficient value to compensate for the lack of a more substantial cash contribution. However, they would not be allowed as consideration for the issuance of new shares under applicable Idaho law. See Idaho Const. art. XI, § 9 ("No corporation shall issue stocks or bonds, except for labor done, services performed, or money or property actually received; and all fictitious increase of stock shall be void."); Idaho Code § 30-1-19 ("The consideration for the issuance of shares may be paid, in whole or in part, in cash, in other property, tangible or intangible, or in labor or services actually performed for the corporation."). Thus, they should not be considered part of the equity cushion of this reorganized corporation.

Accordingly, the reorganization plan does not satisfy the feasibility standard and should not be confirmed.

Even if this Court concludes that the record is not sufficiently clear to decide on confirmation of the reorganization plan, the Court should specify the standard clearly enough for the lower courts to apply. The standard should be based on the capital structure of the reorganized company having an equity cushion that is adequate to withstand reasonably foreseeable variations in future earnings. The adequacy of the equity cushion may be determined by comparison to the capital structures of similar businesses and from testimony of financial experts.

CONCLUSION

Inseparable from the issue of whether a new capital exception to the absolute priority rule should exist is the question of what its parameters should be. In addition to recognizing this exception, this Court should enunciate reasonable standards for the form and amount of the new capital required for confirmation of a reorganization plan.

Respectfully submitted,

CHARLES W. ADAMS
Professor of Law
The University of Tulsa College
of Law
3120 East Fourth Place
Tulsa, OK 74104
(918) 631-2437

Amicus Curiae

FEB 24 1994

OFFICE OF THE CLERK

No. 93-714

IN THE

Supreme Court of the United States

APRIL TERM, 1994

U.S. BANCORP MORTGAGE COMPANY,

Petitioner,

VS.

BONNER MALL PARTNERSHIP,

Respondent.

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

**BRIEF OF AMICI CURIAE
AMERICAN COUNCIL OF LIFE INSURANCE AND
MORTGAGE BANKERS ASSOCIATION OF AMERICA
IN SUPPORT OF PETITIONER**

ROBERT B. MILLNER

(Counsel of Record)

LORIE A. CHAITEN

Sonnenschein Nath & Rosenthal

8000 Sears Tower

233 S. Wacker Drive

Chicago, Illinois 60606-6404

(312) 876-8000

Of Counsel:

RICHARD E. BARNSBACK

PHILLIP E. STANO

DAVID M. LEIFER

American Council of Life Insurance

1001 Pennsylvania Avenue, N.W.

Washington, D.C. 20004-2599

(202) 624-2183

*Counsel for Amici Curiae***WILLIAM E. CUMBERLAND**

Mortgage Bankers Association of America

1125 Fifteenth Street, N.W.

Washington, D.C. 20005-2766

(202) 861-6516

421P

TABLE OF CONTENTS

	Page
TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	iii
INTEREST OF AMICI CURIAE	1
STATEMENT	3
The Single Asset Case	3
The Bonner Mall Property	4
The Plan of Reorganization	5
Proceedings Regarding New Value Exception	6
1. Bankruptcy Court Decision	6
2. District Court Decision	7
3. Court of Appeals Decision	7
SUMMARY OF ARGUMENT	9
ARGUMENT	10
A. THE ABSOLUTE PRIORITY RULE BARS THE GRANT, TO OWNERS OF AN INSOLVENT ENTERPRISE, OF AN EXCLUSIVE RIGHT TO PURCHASE THE REORGANIZED DEBTOR AT A PRICE SET BY OLD EQUITY WITHOUT OPPORTUNITY FOR COMPETITIVE BID OR COUNTERPROPOSAL	10
1. Under The Absolute Priority Rule, The Debtor's Assets Are Properly Treated As Owned By The Creditors	10

TABLE OF CONTENTS - Continued

	Page
2. The "New Value" Exception Adopted By The Court Of Appeals Gives "Property" "On Account Of" Old Equity's Prior Ownership Interest, In Violation Of The Code	13
3. The Court Of Appeals' Reasoning, And Particularly Its Reliance On <i>Los Angeles Lumber</i> , Is Misplaced.....	16
4. There Is No Policy Justification For A Preemptive New Value Rule	18
5. At The Very Least, A Cramdown Sale Of Ownership To Old Equity Cannot Be Confirmed Without Exposing That Transaction To The Market.....	20
B. THE PLAIN MEANING OF THE STATUTORY TEXT SHOULD BE HELD TO CONTROL CONSTRUCTION OF SECTION 1129(b)	23
CONCLUSION.....	29

TABLE OF AUTHORITIES

Cases:	Page
<i>In re A.V.B.I., Inc.</i> , 143 B.R. 738 (Bankr. C.D. Cal.1992)	14, 18, 23, 26
<i>In re Bjolmes Realty Trust</i> , 134 B.R. 1000 (Bankr. D. Mass. 1991)	21
<i>In re Bonner Mall Partnership</i> , 2 F.3d 899 (9th Cir. 1993)	3, 4
<i>In re Bryson Properties, XVIII</i> , 961 F.2d 496 (4th Cir.), cert. denied, 113 S. Ct. 191 (1992)	8, 14 15, 18
<i>Case v. Los Angeles Lumber Products Co.</i> , 308 U.S. 106 (1939).....	7, 14, 16, 17, 24, 26, 27
<i>Consolidated Rock Products Co. v. Du Bois</i> , 312 U.S. 510 (1941).....	12
<i>Dewsnup v. Timm</i> , 502 U.S. ___, 112 S. Ct. 773 (1992)	7, 8, 23, 24, 25, 28
<i>In re Greystone III Joint Venture</i> , 995 F.2d 1274 (5th Cir.), petition for rehearing granted in part and opinion withdrawn in part, 995 F.2d 1284 (5th Cir.) (per curiam), cert. denied, 113 S. Ct. 72 (1992)	14
<i>Kansas City Terminal Ry. Co. v. Central Union Trust Co.</i> , 271 U.S. 445 (1926)	16
<i>Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting</i> , 908 F.2d 1351 (7th Cir. 1990)	12, 14, 27
<i>In re Lumber Exchange Ltd. Partnership</i> , 125 B.R. 1000 (Bankr. D. Minn.), aff'd on other grounds, 134 B.R. 354 (D. Minn. 1991), aff'd, 968 F.2d 647 (8th Cir. 1992)	18

TABLE OF AUTHORITIES - Continued

	Page
<i>Northern Pacific Railway Co. v. Boyd.</i> 228 U.S. 482 (1913).....	12
<i>Norwest Bank Worthington v. Ahlers,</i> 485 U.S. 197 (1988).....	12, 14, 20, 24, 26, 27
<i>In re One Times Square Assocs. Ltd. Partnership,</i> 159 B.R. 695 (Bankr. S.D.N.Y. 1993).....	24
<i>In re Outlook/Century Ltd.</i> , 127 B.R. 650 (Bankr. N.D. Cal. 1991)	18, 21, 23
<i>Pepper v. Litton</i> , 308 U.S. 295 (1939).....	18
<i>Piedmont Associates v. Cigna Property & Casualty Insurance Co.</i> , 132 B.R. 75 (N.D. Ga. 1991).....	18, 19
<i>In re Ropt Ltd. Partnership</i> , 152 B.R. 406 (Bankr. D. Mass. 1993)	21
<i>In re S.A.B.T.C. Townhouse Ass'n, Inc.</i> , 152 B.R. 1005 (Bankr. M.D. Fla. 1993)	24
<i>In re SM 104 Ltd.</i> , 160 B.R. 202 (Bankr. S.D. Fla. 1993)	20
<i>In re Snyder</i> , 967 F.2d 1126 (7th Cir. 1992)	24
<i>Toibb v. Radloff</i> , 501 U.S. ___, 111 S. Ct. 2197 (1991)	18
<i>United Savings Assn. of Texas v. Timbers of Inwood Forest Assoc., Ltd.</i> , 484 U.S. 365 (1988).....	5
<i>United States v. Ron Pair Enterprises, Inc.</i> , 489 U.S. 235 (1989).....	24, 25
<i>Wolf v. Weinstein</i> , 372 U.S. 633 (1963)	18

TABLE OF AUTHORITIES - Continued

	Page
Statutes:	
<i>Bankruptcy Act of 1898</i> , 11 U.S.C. <i>et seq.</i> (repealed 1979):	
Ch. X, 11 U.S.C. § 501 <i>et seq.</i>	17, 25, 26
Ch. X, § 221 (formerly codified as amended at 11 U.S.C. § 621)	26
Ch. XI, 11 U.S.C. § 701 <i>et seq.</i>	25, 26
Ch. XII, 11 U.S.C. § 801	25, 26
<i>Bankruptcy Code</i> , 11 U.S.C. § 101 <i>et seq.</i> :	
11 U.S.C. § 109.....	12
11 U.S.C. § 362(a)	4
11 U.S.C. § 362(d)	4, 5
11 U.S.C. § 506(a)	5
11 U.S.C. § 506(d)	6
11 U.S.C. § 1107.....	15, 26
11 U.S.C. § 1108.....	15, 26
11 U.S.C. § 1121(b), (c)	15, 26
11 U.S.C. § 1121(d)	15
11 U.S.C. § 1129(a)(8)(A)	13, 27
11 U.S.C. § 1129(b)(1).....	11
11 U.S.C. § 1129(b)(2).....	20, 23
11 U.S.C. § 1129(b)(2)(B)	10, 11

TABLE OF AUTHORITIES - Continued

	Page
11 U.S.C. § 1129(b)(2)(B)(i)	10
11 U.S.C. § 1129(b)(2)(B)(ii) 1, 8, 9, 13, 14, 18, 23	
Other Authorities:	
American Council of Life Insurance, <i>1993 Life Insurance Fact Book Update</i> (1993)	1, 2
American Council of Life Insurance, <i>1992 Life Insurance Fact Book</i> (1992)	1, 2
Appellant's Reply Brief, in the United States Court of Appeals for the Ninth Circuit	15
John T. Bailey, <i>The "New Value Exception" in Single-Asset Reorganizations: A Commentary on the Bjolmes Auction Procedure and Its Relationship to Chapter 11</i> , 98 Com. L.J. 50 (1993)	28
Douglas G. Baird, <i>The Elements of Bankruptcy</i> (1992)	1, 19
Brief for the United States as <i>Amicus Curiae Supporting Petitioners</i> , <i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988) (No. 86-958)	24, 26, 27
<i>5 Collier on Bankruptcy</i> (Lawrence P. King ed., 15th ed. 1993)	25, 26
Walter A. Effross, <i>Grammarians At The Gate: The Rhenquist Court's Evolving "Plain Meaning" Approach to Bankruptcy Jurisprudence</i> , 23 Seton Hall L. Rev. 1636 (1993)	25

TABLE OF AUTHORITIES - Continued

	Page
Richard J. Epling, <i>The New Value Exception: Is There A Practical Workable Solution?</i> , 8 Bankr. Dev. J. 335 (1991)	22
1 David G. Epstein <i>et al.</i> , <i>Bankruptcy</i> (1992)	22
3 David G. Epstein <i>et al.</i> , <i>Bankruptcy</i> (1992)	10, 12, 19, 27
Lisa Hill Fenning, <i>et al.</i> , <i>Good Faith: Roundtable Discussion</i> , 1 Am. Bankr. Inst. L. Rev. 11 (1993)	3
Lawrence B. Gutcho, <i>Real Estate Lenders and the Battle Over "New Value,"</i> 110 Banking L.J. 423 (1993)	22
Bruce A. Markell, <i>Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations</i> , 44 Stan. L. Rev. 69 (1991)	17, 18, 22, 26, 27
Anthony L. Miscioscia, Jr., <i>The Bankruptcy Code And The New Value Doctrine: An Examination Into History, Illusions, And The Need For Competitive Bidding</i> , 79 Va. L. Rev. 917 (1993)	18, 22
Michael L. Molinaro, <i>Single-Asset Real Estate Bankruptcies: Curbing an Abuse of the Bankruptcy Process</i> , 24 UCC L.J. 161 (1991)	4
National Bankruptcy Conference, <i>Bankruptcy Reform Circa 1993</i> 255 (ALI-ABA 1993)	13, 22
Note, <i>The New Value Exception: Square Peg In A Round Hole</i> , 1 Am. Bankr. Inst. L. Rev. 173 (1993)	4

TABLE OF AUTHORITIES - Continued

	Page
Robert K. Rasmussen, <i>A Study Of The Costs And Benefits Of Textualism: The Supreme Court's Bankruptcy Cases</i> , 71 Wash. U.L.Q. 535 (1993)	25
Leonard M. Rosen, <i>Book, Chapter And Worse</i> , July-Aug. 1992 Business Law Today 47	19
Linda J. Rusch, <i>Single Asset Cases and Chapter 11: The Classification Quandary</i> , 1 Am. Bankr. Inst. L. Rev. 43 (1993)	4
Stephen W. Sather & Adrian M. Overstreet, <i>The Single-Asset Real Estate Debtor: A Selective Overview</i> , 2 J. Bankr. L. Prac. 343 (1993)	26
Elizabeth Warren, <i>A Theory of Absolute Priority</i> , 1991 Ann. Surv. Am. L. 9 (1992)	1, 19, 21, 22

**BRIEF OF AMICI CURIAE
AMERICAN COUNCIL OF LIFE INSURANCE AND
MORTGAGE BANKERS ASSOCIATION
OF AMERICA IN SUPPORT OF PETITIONER**

This Brief, in support of Petitioner, is submitted in accordance with Rule 37 of the Rules of this Court and pursuant to the attached written consent of all parties.

INTEREST OF AMICI CURIAE

Amicus American Council of Life Insurance ("ACLI") is the principal national trade association of life insurers. ACLI's 634 member companies account for 90% of the legal reserve life insurance in this country and are among the nation's largest and most significant commercial lenders. In 1992, life companies' net new investment in U.S. capital markets totaled \$107.3 billion — ranking second (only after mutual funds) among private domestic capital sources.¹

The interest of ACLI arises out of the signal importance the decision below has to the commercial lending community. The issue presented — the existence and content of a new value exception to the absolute priority rule — lies at the core of bankruptcy reorganization. The absolute priority rule, as codified in Section 1129(b)(2)(B)(ii) of the Bankruptcy Reform Act of 1978 (the "Bankruptcy Code"), 11 U.S.C. § 101 *et seq.*, sets forth the fundamental ordering of rights and priorities between equity owners and creditors and "sets the ground rules of Chapter 11."²

¹ American Council of Life Insurance, *1993 Life Insurance Fact Book Update* 46-54 (1993); see also American Council of Life Insurance, *1992 Life Insurance Fact Book* 84-103 (1992).

² Douglas G. Baird, *The Elements of Bankruptcy* 73 (1992); see also Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L. 9 (1992).

ACLI is also interested in this case because it concerns a defaulted mortgage loan and a commercial borrower's attempt judicially to impose a mortgage restructuring over the lender's objection. Life insurance companies are among the nation's largest direct lenders of mortgage money and purchasers of mortgages on the secondary mortgage market. At the end of 1992, life insurance companies held \$242 billion in mortgages on United States real property, which represented 14.8 percent of the total assets held by life insurance companies that year.³

Amicus Mortgage Bankers Association of America ("MBAA") is the primary national trade association devoted to the field of mortgage and real estate financing. Mortgage banking firms, which comprise the largest part of MBAA's total membership of 2,600 corporations, engage in originating, financing, selling and servicing both residential and commercial mortgages. In 1993, MBAA members originated \$12.8 billion in mortgage loans on commercial real estate and serviced in excess of \$160 billion in commercial real estate mortgages. MBAA has the same interests as ACLI in this case.

As principal sources of mortgage funds and other investment capital in the United States, *amici* have a broad perspective on the merits of this case and the impact of the court of appeals decision. That decision not only (a) upholds the existence of a "new value" exception to the absolute priority rule, so that old equity, despite objection by a creditor class that will not be paid in full, may purchase ownership of the reorganized debtor, but (b) holds that old equity can be granted an *exclusive* right to purchase that ownership on terms set without competitive bid or other market exposure.

³ American Council of Life Insurance, *1993 Life Insurance Fact Book Update*, *supra*, at 46, 50; see also American Council of Life Insurance, *1992 Life Insurance Fact Book*, *supra*, at 85, 99. Moreover, life insurance companies held an additional \$248.6 billion in mortgage related securities at the end of 1992. American Council of Life Insurance, *1993 Life Insurance Fact Book Update* at 49.

Amici support the position of Petitioner U.S. Bancorp Mortgage Company ("Bancorp"), which would bar old equity's ownership of the reorganized debtor unless the unsecured class is paid in full. *Amici* submit this brief, however, to urge that, regardless of whether the Court accepts Bancorp's position *in toto*, there is no basis in law for the grant of an exclusive right to old equity to purchase ownership of the reorganized entity — at a price old equity names without bid — over the objection of a class of unsecured creditors that will not be fully paid.

STATEMENT

The Single Asset Case

This case presents the familiar pattern of a single asset real estate case in Chapter 11. Such a case involves a debtor, like Respondent Bonner Mall Partnership (the "Debtor"), which owns a single commercial real estate asset (shopping mall, apartment complex, or office building) that generates substantially all the debtor's gross income. See Lisa Hill Fenning, *et al.*, *Good Faith: Roundtable Discussion*, 1 Am. Bankr. Inst. L. Rev. 11, 17-18 (1993). Single asset cases comprise a substantial portion — in some districts as much as half — of all Chapter 11 filings. *Id.* at 14-15.

In a single asset case, the asset often is fully encumbered by mortgage debt, with no equity value available for unsecured claimants or the owners. In the case at hand, the total mortgage debt owed to Bancorp was \$6.6 million, while the collateral — a shopping mall — was valued by the bankruptcy court at \$3.2 million. *In re Bonner Mall Partnership*, 2 F.3d 899, 905 (9th Cir. 1993).

In general, the crux of the single asset case is a dispute between the debtor and a single creditor, the mortgage lender. That lender is a potential bidder for ownership of the property.

Typically there are few trade creditors, and their claims, which are unsecured, often are dwarfed by the mortgage lender's unsecured deficiency claim. Linda J. Rusch, *Single Asset Cases And Chapter 11: The Classification Quandary*, 1 Am. Bankr. Inst. L. Rev. 43, 44-45 (1993). In the present case, for example, Bancorp's deficiency claim constitutes almost all the unsecured debt. *See infra* at 6.

The single asset debtor generally has few, if any, employees, and the property is often run by a management company. Upon sale or foreclosure, the property will continue to be operated without any loss of going concern value. *See Note, The New Value Exception: Square Peg In A Round Hole*, 1 Am. Bankr. Inst. L. Rev. 173, 192-93 (1993); Michael L. Molinaro, *Single-Asset Real Estate Bankruptcies: Curbing an Abuse of the Bankruptcy Process*, 24 UCC L.J. 161, 163-64 (1991).

The Bonner Mall Property

The Debtor here purchased the property at issue in October 1986, subject to Bancorp's lien. *Bonner Mall*, 2 F.3d at 901. The Debtor experienced cash flow difficulties and failed to pay real estate taxes. *Id.* at 902. In July 1990, Bancorp commenced a nonjudicial foreclosure action. *Id.*; P.A. A92.⁴ After unsuccessful attempts to renegotiate and restructure the debt, Bancorp set a foreclosure sale for March 14, 1991. 2 F.3d at 902.

On the eve of foreclosure, the Debtor filed a voluntary Chapter 11 petition, thereby automatically staying the foreclosure sale. *Id.* *See also* 11 U.S.C. § 362(a). Soon thereafter, Bancorp moved for relief from the automatic stay under Code Section 362(d)(2), arguing that the debtor has no equity in the property on which the creditor seeks to foreclose and the property "is not necessary to an effective reorganization." 11 U.S.C. § 362(d)(2).

⁴ Citations to Petitioner's Appendix, attached to the Petition for Writ of Certiorari, appear as "P.A. ____." Citations to the Joint Appendix appear as "J.A. ____."

The bankruptcy court valued the mall at \$3.2 million, establishing that the Debtor had *no* equity in the property. As a result, the bankruptcy court ruled that the Debtor had to show "a reasonable possibility of a successful reorganization within a reasonable time" in order to defeat Bancorp's motion for relief from the stay. P.A. A121, 126 (citation omitted).⁵

The Plan of Reorganization

On October 31, 1991, in response to the bankruptcy court's ruling, the Debtor filed its First Amended Plan of Reorganization (the "Plan"). P.A. A93. Under the Plan, the Debtor would transfer all its assets to a new entity, Bonner Properties, Inc. (the "Reorganized Debtor"). J.A. 19, Plan § 7.1. The Debtor's existing partners (old equity) would retain their ownership of the mall by purchasing 2,000,000 shares (100%) of the Reorganized Debtor's common stock for \$200,000 cash. J.A. 18, 19, Plan §§ 5.5.1, 7.2. Old equity's right to acquire this common stock would be exclusive. *Id.*⁶

Pursuant to Section 506(a) of the Bankruptcy Code, Bancorp's \$6.6 million claim would be divided into a secured claim to the extent of the value of the collateral (\$3.2 million) and an unsecured deficiency claim of \$3.4 million. 2 F.3d at 905.

⁵ Such showing is required to prove that the collateral is "necessary to an effective reorganization" for purposes of Section 362(d) of the Bankruptcy Code. *United Savings Assn. of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 375-76 (1988).

⁶ Old equity also would undertake to fund any shortfall in the Reorganized Debtor's working capital for a 32 month period. J.A. 19, Plan § 7.2. In addition, an affiliate of the Debtor would contribute a junior mortgage on certain real property, the value of which was disputed, to guarantee obligations assumed by the Reorganized Debtor. In exchange for this collateral, however, the Reorganized Debtor would be required to service a substantial portion (\$902,000) of the debt on that property. J.A. 20, Plan § 7.5.

Under Section 506(d) of the Bankruptcy Code, Bancorp's prepetition \$6.6 million lien would be voided to the extent it exceeded the \$3.2 million value of the collateral. The unsecured portion of Bancorp's claim represented the vast bulk (approximately 93%) of the Debtor's unsecured debt. *Id.*; P.A. A123.

Under the Plan, the \$3.2 million secured portion of Bancorp's claim would be paid 32 months after the Plan's confirmation, with monthly interest payments at the rate of 7% per annum in the interim. J.A. 16-17, Plan § 5.3.1.

Bancorp, however, would receive no cash payment on its \$3.4 million deficiency claim. J.A. 17, Plan § 5.4.1. Nor would any cash payment be made on any other unsecured claims in excess of \$1,000. *Id.* Instead, all unsecured claims would be satisfied through a pro rata distribution of 300,000 shares of redeemable preferred stock in the Reorganized Debtor. Each share would have a par value and liquidation preference of \$1.00. J.A. 17, 21-22, Plan §§ 5.4.1, 7.3. After final payment of Bancorp's secured claim, the preferred stock would be convertible into 300,000 shares of common stock (15% of the then outstanding common shares of the Reorganized Debtor). *Id.* In short, the holders of unsecured claims would receive preferred stock worth, at best, less than ten cents on the claim dollar. 2 F.3d at 905.

Proceedings Regarding New Value Exception

1. Bankruptcy Court Decision

After the Debtor filed its Plan, Bancorp renewed its motion for relief from the stay, arguing, *inter alia*, that a new value exception was not viable under the 1978 Bankruptcy Code and that the Plan violated the absolute priority rule. J.A. 29, 31. The bankruptcy court accepted this argument and granted Bancorp's motion. J.A. 29-33.

2. District Court Decision

On appeal, the district court reversed in reliance on this Court's decision in *Dewsnup v. Timm*, 502 U.S. ___, 112 S. Ct. 773 (1992), which the court viewed as "prescrib[ing] new standards for interpreting the Bankruptcy Code." P.A. A110. Under *Dewsnup*, as interpreted by the district court, "courts should try to construe the language [of the Bankruptcy Code] as consistent with pre-Code practices, unless some contrary intent is shown in the legislative history." P.A. A111.

Based on this Court's decision in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), the district court concluded that a new value exception had existed under the old 1898 Bankruptcy Act. Consistent with its understanding of *Dewsnup*, the district court ruled that the new value exception "survive[d] the enactment of the 1978 Bankruptcy Code." P.A. A116.

3. Court of Appeals Decision

The court of appeals affirmed the district court and remanded to the bankruptcy court for further proceedings. The court of appeals held "that the Code permits the confirmation of a reorganization plan that provides for the infusion of capital by the shareholders of the bankrupt corporation in exchange for stock if the plan meets the conditions that plans were required to meet prior to the Code's adoption." 2 F.3d at 907. The court reasoned that:

(i) "[T]he plain language of section 1129(b)(2)(B)(ii) [absolute priority rule]" does not "by its terms eliminate, or even refer to, the new value exception." *Id.* at 908, 909-10.

(ii) This Court had recognized a new value exception under the old Act in *Los Angeles Lumber*. *Id.* at 906.

(iii) Under *Dewsnup*, “[w]here the text of the Code does not unambiguously abrogate pre-Code practice, courts should presume that Congress intended it to continue unless the legislative history dictates a contrary result.” *Id.* at 913.

The court of appeals acknowledged that Code Section 1129(b)(2)(B)(ii) “bars old equity from receiving any property via a reorganization plan ‘on account of’ its prior equitable ownership when all senior claim classes are not paid in full.” *Id.* at 908. It concluded, however, that under the new value exception, the prior owners “participate in the reorganized debtor *on account of* a substantial, necessary, and fair new value contribution.” *Id.* at 909. The court of appeals stated that the new value doctrine should be viewed not as an exception to absolute priority but rather as a “corollary” stating “the set of conditions under which former shareholders may lawfully obtain a priority interest in the reorganized venture.” *Id.* at 906.

Perhaps most importantly, the court of appeals ruled that the new value exception permits confirmation of a plan that gives old equity *alone* the right to obtain an interest in the reorganized debtor. *Id.* at 910-11. In the court’s view, the courts have power to afford such investors “a priority over an impaired class of creditors.” *Id.* at 915. “The risk of self-dealing among these entities [debtor and old equity] at the expense of creditors is a risk created by the Code itself.” *Id.*

The court of appeals rejected the holdings of the Fourth Circuit in *In re Bryson Properties, XVIII*, 961 F.2d 496 (4th Cir.), *cert. denied*, 113 S. Ct. 191 (1992), and other cases, that such exclusive purchase right, in and of itself, constitutes property received “on account of” old equity’s prior ownership. 2 F.3d at 910-11. In the view of the court of appeals, vesting a preemptive purchase right in old equity, without exposing the interest being purchased to the market, “increases the amount available for the estate to use both in its reorganization and in funding the plan and paying creditors.” *Id.* at 915.

SUMMARY OF ARGUMENT

The brief of Petitioner Bancorp presents ample authority demonstrating that under the absolute priority rule equity owners cannot participate in a reorganized enterprise over the dissent of a class of unsecured creditors who will not be paid in full. Although *amici* agree with Bancorp’s position, pursuant to Supreme Court Rule 37, *amici* will not repeat Bancorp’s legal presentation.

Amici submit this brief to urge that, regardless of the Court’s ruling as to the existence *vel non* of a new value exception, there is *no* basis in law for the grant of an *exclusive* right to old equity to purchase ownership of the reorganized debtor over the objection of a class of unsecured creditors that will not be fully paid. Any such preemptive proprietary right in old equity is directly contrary to Section 1129(b)(2)(B)(ii) of the Bankruptcy Code, which prohibits old equity from receiving any property (including exclusive purchase rights) on account of its prior ownership, where an objecting creditor class will not be made whole on its debt.

Amici submit that the words of the statute are indisputably clear on this point. In light of conflicting judicial approaches to Bankruptcy Code construction, *amici* urge the Court to rule and reiterate that natural interpretation of plain statutory language should control absent compelling reason to the contrary. Here there is no such compelling reason.

ARGUMENT

A. THE ABSOLUTE PRIORITY RULE BARS THE GRANT, TO OWNERS OF AN INSOLVENT ENTERPRISE, OF AN EXCLUSIVE RIGHT TO PURCHASE THE REORGANIZED DEBTOR AT A PRICE SET BY OLD EQUITY WITHOUT OPPORTUNITY FOR COMPETITIVE BID OR COUNTERPROPOSAL.

1. Under The Absolute Priority Rule, The Debtor's Assets Are Properly Treated As Owned By The Creditors.

The absolute priority rule is expressly codified, without exception, in Section 1129(b)(2)(B) of the Bankruptcy Code. The rule provides that the debtor must pay a nonconsenting class of unsecured creditors in full⁷ or “the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.” 11 U.S.C. § 1129(b)(2)(B).⁸

⁷ For purposes of making payment in full under Section 1129(b)(2)(B)(i), the debtor may pay creditors over time as long as the present value of the time payment at least equals the allowed amount of the claim. The property received by the creditors may be “tangible or intangible, including securities of the debtor or a successor to the debtor under a plan of reorganization.” 3 David G. Epstein *et al.*, *Bankruptcy* § 10-21 (1992).

⁸ Section 1129(b)(2)(B) provides:

For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

♦ ♦ ♦

footnote continued on page 11

The absolute priority rule is part of the Code’s requirement that a reorganization plan be “fair and equitable” in order to be confirmed over objection of an unsecured creditor class that will not be paid in full. 11 U.S.C. § 1129(b)(1).⁹ It is rooted in the concept that when an enterprise is insolvent, *i.e.*, the entity’s

footnote continued from page 10

(B) With respect to a class of unsecured claims

- (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
- (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. § 1129(b)(2)(B).

⁹ Confirmation of a plan over objection of an impaired creditor class, pursuant to Section 1129(b)(1), is commonly referred to as a “cramdown.” Section 1129(b)(1) provides:

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) [acceptance of the plan by all impaired classes] are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

11 U.S.C. § 1129(b)(1).

debts exceed the present values of its assets, its assets are properly treated as owned by the creditors.¹⁰

As a principle of reorganization law, absolute priority had its origins in railroad equity receiverships. 3 David G. Epstein *et al.*, *Bankruptcy* § 11-25 (1992). As stated in a seminal receivership case:

The property [of the debtor] was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor, was invalid.

Northern Pacific Railway Co. v. Boyd, 228 U.S. 482, 504 (1913).¹¹

Likewise today, “[c]reditors effectively own bankrupt firms.” *Kham & Nate’s Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1360 (7th Cir. 1990). The Bankruptcy Code allows the creditors to consent to a plan that impairs their

¹⁰ The Bankruptcy Code does *not* require that an entity be insolvent in order to be eligible to seek Chapter 11 relief. See 11 U.S.C. § 109. Solvent companies, *i.e.*, entities whose asset values exceed their debts, can and sometimes do file for relief when they are unable to pay obligations coming due.

¹¹ A basic premise of absolute priority is that the entire going concern value of the insolvent debtor belongs to the creditors. *Boyd*, 228 U.S. at 508 (“If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatsoever.”). *Accord Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 208 (1988). See also 3 Epstein, *supra*, § 11-30; *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 529 (1941).

interests — in which case they sell ownership to old equity at an agreed price or give up equity interests in order to induce managers to stay on. See 11 U.S.C. § 1129(a)(8)(A).

On the other hand, under the absolute priority rule, the creditors can reject a “new value” plan if they believe the proposed equity payment to be inadequate — in which case confirmation should be flatly denied (as urged by Bancorp) or at a minimum competing bids for ownership of the reorganized debtor should be allowed.

As set forth by the National Bankruptcy Conference, in its recently released report on operation of the Code:

If creditor acceptance is not obtained, the market has determined there is not sufficient new value to permit the owners of an insolvent enterprise to retain any interest in the reorganized entity.

National Bankruptcy Conference, *Bankruptcy Reform Circa 1993* 255 (ALI-ABA 1993).

2. The “New Value” Exception Adopted By The Court Of Appeals Gives “Property” “On Account Of” Old Equity’s Prior Ownership Interest, In Violation Of The Code.

Indisputably, the plain terms of Section 1129(b)(2)(B)(ii) bar old equity from receiving “any property” “on account of” its prior ownership interest. The new value exception, as adopted by the court of appeals in this case, permits insiders to acquire the reorganized debtor in a private sale at which no other bidders are allowed and on terms rejected by the creditors, for whose benefit

ownership should be being sold.¹² The only redress the creditors have is to seek a judicial upset of the sale, arguing that the purchase price and terms do not meet the requirements of the new value exception set forth in the pre-Code dicta of *Los Angeles Lumber*, 308 U.S. 106.¹³

This exclusive right to purchase ownership is property. *See supra* at 12 n.11. Even the court of appeals acknowledged that a “stock purchase option is property.” 2 F.3d at 910 n.27. *See also Bryson Properties*, 961 F.2d at 504; *Kham & Nate’s Shoes*, 908 F.2d at 1360 (holding that an option to purchase stock is “property” under Section 1129(b)(2)(B)(ii)); *In re A.V.B.I., Inc.*, 143 B.R. 738, 740 (Bankr. C.D. Cal. 1992) (same). *See also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-08 (1988) (holding that a retained equity interest is “property” even if it has no market value).

¹² Application of this exception is graphically illustrated by the *Greystone* case. There, the bankruptcy court confirmed a “new value” plan which would have paid less than 4 cents on the dollar on unsecured claims, after refusing to consider a proposal by the mortgage lender to fund a plan of its own which would have paid all unsecured creditors in full, in cash, at confirmation. *In re Greystone III Joint Venture*, 995 F.2d 1274, 1277 (5th Cir.), *petition for rehearing granted in part and opinion withdrawn in part*, 995 F.2d 1284 (5th Cir.) (*per curiam*), cert. denied, 113 S. Ct. 72 (1992).

¹³ The pre-Code new value exception as adopted by the Ninth Circuit, and incorporated by that court into the Bankruptcy Code, has the following requirements:

Former equity owners [are] required to offer value that [is]
1) new, 2) substantial, 3) money or money’s worth,
4) necessary for a successful reorganization and 5) reasonably
equivalent to the value or interest received.

2 F.3d at 908 (citing *Los Angeles Lumber*, 308 U.S. at 121-22).

Therefore, what this case turns on (*if old equity is permitted to participate in ownership over creditor objection*), is whether this exclusive purchase option (property) is received “on account of” old equity’s prior ownership.

The answer emphatically is yes. This preemptive right, if it exists, arises solely because in Chapter 11: (a) the debtor’s pre-petition owners and their managers are generally permitted to remain in control of the debtor as a “debtor in possession,” 11 U.S.C. §§ 1107, 1108; and (b) the debtor has an exclusive right for 120 days to propose a reorganization plan and an additional 60 day exclusive period to obtain acceptance of the plan. 11 U.S.C. § 1121(b), (c). In addition, extensions of exclusivity can be (and are) granted. *See* 11 U.S.C. § 1121(d).

Here, the court of appeals went out of its way to establish an exclusive purchase right in old equity. As the court of appeals noted, the Debtor had filed its plan after its exclusivity period had expired. Nevertheless, the court of appeals announced that even if plan exclusivity had not expired, “[w]e do not believe that this exclusivity period . . . makes the new value exception objectionable under the Code.” 2 F.3d 910 n.26. “We believe that this same analysis [rejecting the Fourth Circuit’s position in *Bryson Properties*] applies whether a plan gives old equity an exclusive or non-exclusive right of participation in a new value transaction.” *Id.* at 911.¹⁴

Contrary to the court of appeals’ position, the right to exclude others from equity ownership is material. Under the

¹⁴ Indeed, Bancorp advised the court of appeals that it would bid more than the Debtor in cash (rather than the securities offered by the Debtor) in a market transaction. *See* Appellant’s Reply Brief, in the United States Court of Appeals for the Ninth Circuit, at 12-13. But for the Ninth Circuit’s decision to establish a preemptive exclusive purchase right in old equity, the case could have returned to the bankruptcy court for resolution of competing bids.

present Code framework, it is only old equity's status and role as debtor in possession that even arguably gives it an exclusive opportunity to confirm a plan in which it sells ownership back to itself while holding all competitors at bay.

3. The Court Of Appeals' Reasoning, And Particularly Its Reliance On *Los Angeles Lumber*, Is Misplaced.

The court of appeals stated that old equity's exclusive purchase may be "on account of" "other reasons." *See* 2 F.3d at 910. This argument is unpersuasive. The court of appeals posits that the "other reasons" might be a belief that old equity "will enhance the value of the business" or that "there will be no other legitimate investors. . ." *Id.* at 911. Yet, the only way to test the validity of these "other reasons" is to open the process to counterproposals from creditors or other parties in interest — which is precisely what the court of appeals refused to do.

The court of appeals' reliance on pre-Code dicta of *Los Angeles Lumber*, 308 U.S. 106, is misplaced and ironic. In *Los Angeles Lumber*, the Court stated, in the course of rejecting a reorganization plan, that participation of old equity could be permissible only if the old stockholders are the only available source of capital investment.

'Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them, unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them....'

308 U.S. at 117 (quoting *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926)).

Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

Id. at 121.

If *Los Angeles Lumber* is at all pertinent to construction of Code Section 1129(b), it invalidates the notion of a preemptive purchase right in old equity. Indeed, it teaches that old equity is a capital source of last resort. It assumes that the market has not and will not provide a superior offer.

Moreover, the new value dicta of *Los Angeles Lumber* and other cases under the old Bankruptcy Act do not address or consider the grant of operational control and exclusivity rights to old equity, because the provisions of the old Act under which those cases arose, Chapter X and its predecessor, Section 77B, did not provide any such rights. *See infra* at 26-27. *See also* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 118 (1991) ("[E]xclusivity with respect to plans subject to the fair and equitable requirement is a Code innovation. . ."). The controversy as to old equity's alleged preemptive purchase right only arises in the context of a Code that grants an exclusivity period and control rights to a debtor in possession.

As the Fourth Circuit concluded in *Bryson Properties*, “[t]his exclusive right to contribute constitutes ‘property’ under § 1129(b)(2)(B)(ii), which was received or retained on account of a prior interest.” 961 F.2d at 504.¹⁵

4. There Is No Policy Justification For A Preemptive New Value Rule.

This Court has recognized that the policies underlying Chapter 11 of the Bankruptcy Code are to maximize the value of the estate and to encourage business reorganization, thereby preserving jobs and protecting investors. *Toibb v. Radloff*, 501 U.S. ___, 111 S. Ct. 2197, 2201 (1991). The court of appeals’ new value rule serves only to undermine these policies.

Old equity’s exercise of an exclusive purchase right raises the palpable risk that the estate will be robbed of value. The “new value” transaction is an exercise in self-dealing. Both sides of the transaction — the decision to sell and decision to buy — are within control of the same persons, old equity. Accordingly, the decision of the court of appeals sets up dangerous incentives for the debtor and its pre-petition owners to violate their fiduciary duties to creditors. *See Pepper v. Litton*, 308 U.S. 295, 306-07 (1939). *See also Wolf v. Weinstein*, 372 U.S. 633, 649-50 (1963).

¹⁵ See also *In re Lumber Exchange Ltd. Partnership*, 125 B.R. 1000, 1008 (Bankr. D. Minn.), aff’d on other grounds, 134 B.R. 354 (D. Minn. 1991), aff’d, 968 F.2d 647 (8th Cir. 1992) (“A special opportunity or right afforded to members of a class of equity security holders to retain or acquire an equity position in a reorganized debtor through a new cash contribution under a plan is, by its very nature, the opportunity or right to receive or retain property on account of the prepetition interest held.”); *In re Outlook/Century Ltd.*, 127 B.R. 650, 654 (Bankr. N.D. Cal. 1991); *Piedmont Associates v. Cigna Property & Casualty Insurance Co.*, 132 B.R. 75, 79 (N.D. Ga. 1991); A.V.B.I., 143 B.R. at 740-41. See also Anthony L. Mischioscia, Jr., *The Bankruptcy Code And The New Value Doctrine: An Examination Into History, Illusions, And The Need For Competitive Bidding*, 79 Va. L. Rev. 917, 946-47 (1993); Markell, *supra*, at 117-21.

The potential for “new value” abuse has been widely recognized.¹⁶ As one district court put it, the old owner “is controlling the sale of the property through the reorganization plan and thereby ensuring himself a bargain basement price.” *Piedmont Associates v. Cigna Property & Casualty Insurance Co.*, 132 B.R. 75, 79 (N.D. Ga. 1991).

Moreover, in Chapter 11, the leverage inherent in any preemptive purchase option is vastly increased by the informational advantage old equity enjoys as debtor in possession. Even the staunchest academic supporter of a new value exception, Professor Elizabeth Warren, notes that “[t]he DIP [debtor in possession] planning to participate in the post-reorganization business has substantial information advantages that permit self-dealing and depress the market for control, notwithstanding the DIP’s fiduciary duties.” Elizabeth Warren, *A Theory of Absolute Priority*, 1991 Ann. Surv. Am. L. 9, 34 (1992).¹⁷ See also Douglas G. Baird, *The Elements of Bankruptcy* 250 (1992).

¹⁶ See, e.g., Leonard M. Rosen, *Book, Chapter and Worse*, July-Aug. 1992 Business Law Today 47, 49 (“Creditors are unfairly treated by a debtor’s use of the so-called ‘new value’ exception.”); 3 Epstein, *supra*, § 11-2 (“Only by arranging for others to investigate the value of the concern and allowing them to bid against the shareholders on a fair basis is one likely to determine the true going-concern value.”).

¹⁷ Professor Warren explains:

The incentives pressing on a DIP who plans to become an owner of the post-reorganization business are clear: keep the ownership value of the business depressed, and buy it for a bargain price in the plan of reorganization. The specter of self-dealing is a powerful concern in any proposed management buyout. Professors Budney and Chirlstein examine this concern in the corporate arena generally, arguing for a per se prohibition on management participation in a buyout. In a bankruptcy reorganization, management self-dealing can rob an estate of value, depriving it of money to pay the outstanding debt.

Warren, *supra*, at 17 (footnote omitted).

Finally, valuation of the interest being sold, without exposing it to the market or providing any opportunity to bid, is problematic, particularly in single asset bankruptcies like this one. Typically, and specifically in this case, even after bankruptcy discharge of the unsecured debt (principally the mortgage lender's deficiency claim), the single asset debtor's property will remain fully encumbered. Under Code Section 1129(b)(2), the lender's mortgage lien will survive the bankruptcy stripped down to the value of the collateral. Therefore, upon confirmation of a plan there will be *no* equity in the property.

This Court's decision in *Ahlers*, however, teaches that ownership of a fully encumbered enterprise has value, however difficult it may be to determine. 485 U.S. at 207-09. At best, the equity value of such reorganized debtor is "highly speculative."¹⁸ In large part, the value of ownership of the reorganized single asset debtor must be based on judgments by market players as to the property's potential for future appreciation and the extent to which current value of the property reflects temporary market dislocation.

5. At The Very Least, A Cramdown Sale Of Ownership To Old Equity Cannot Be Confirmed Without Exposing That Transaction To The Market.

If the equity owners of an insolvent debtor are permitted to participate in ownership of the reorganized debtor, over objection of an impaired unsecured creditor class, there must, at the very least, be opportunity for a competitive bid or counterproposal

¹⁸ "In single asset real estate cases where the property is fully encumbered, the capitalized earnings value presumably has been entirely allocated to the valuation of the secured claim, as required by § 506 and the absolute priority rule. That leaves the question of how to value the highly speculative equity." See *In re SM 104 Ltd.*, 160 B.R. 202, 229 (Bankr. S.D. Fla. 1993).

to set the price of the equity interest being sold. Even Professor Warren acknowledges that market opportunities are advisable. Warren, *supra*, at 23, 26-27. See also *Outlook/Century*, 127 B.R. at 654 n.4 ("[D]ebtor would not retain or receive property 'on account of' its equity interest, if it purchased at a sale that was open to other purchasers and at which the debtor had no advantage"); *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1011 (Bankr. D. Mass. 1991) ("But because every unsecured creditor is granted an identical right [to the right of old equity to bid], this is clearly not the receipt or retention of property 'on account of' a stock interest within the meaning of the statute."). Accord *In re Ropt Ltd. Partnership*, 152 B.R. 406, 412-13 (Bankr. D. Mass. 1993).

In *Bjolmes*, a single asset real estate case, the court required, as a condition to confirmation of the plan, that an auction be held among the shareholders and creditors interested in purchasing a 100% ownership of the reorganized entity. The *Bjolmes* court concluded that in cases involving non-publicly traded shares, "the only way to measure the proposed contribution against actual market value is to offer the stock for sale." 134 B.R. at 1010. "If the fresh contribution exception were applied through valuation by the court, the absence of market forces would give shareholders undue leverage." *Id.* at 1011.¹⁹

Amici submit that the precise contours of any market mechanism, if the Court adopts such an approach, should be fleshed out by lower courts with appropriate record basis. Obviously capital structures of different debtors vary, ranging from the typical single asset debtor's structure (mortgage debt, minimal trade debt and equity) to complex structures of publicly

¹⁹ The court found no need to place the property on the open market to encourage third party buyers because the first mortgagee, the FDIC, had "substantial resources" and "is a likely buyer." *Id.* at 1010. The court ruled that the winner of the auction would be required to consummate the proposed plan, subject to modifications. *Id.* at 1010-11.

traded corporations, with many different layers of debt and equity.

It may be that no single mechanism is appropriate for all case types. For example, the National Bankruptcy Conference suggests an opportunity for competing plans as a solution. *See* National Bankruptcy Conference, *supra*, at 253. “[T]he concept restores a more level paying field.” *Id.* at 255. Other market solutions also have been advanced.²⁰ *Amici* suggest that, in the single asset case, it may be appropriate to require a debtor proposing a new value cramdown (if such cramdown is permitted at all) to set forth a bidding mechanism in the debtor’s plan, so that creditors are not burdened with the time and expense of preparing their own plans and disclosure statements.

This is not to say that an opportunity to bid is a sufficient check against overreaching in every new value transaction. For example, there may be no bidders because of thinness in the market. “In the case of the small business the market for control is likely to be thinnest and the possibility of DIP self-dealing is likely to be highest . . . With a thin market to compete for the purpose of control of a failing business, the DIP may be able to set the price alone.” Warren, *supra*, at 18. Accordingly, courts must closely scrutinize the price and terms of any potential sale of debtor property to an insider and should withhold approval where not satisfied that the estate value is maximized. 1 Epstein,

²⁰ See, e.g., Richard L. Epling, *The New Value Exception: Is There A Practical Workable Solution?*, 8 *Bankr. Dev. J.* 335 (1991) (suggesting *inter alia* that creditors be permitted to credit bid under certain circumstances and also suggesting that a court controlled auction may be fairer than submission of competing plans); Micsoscia, *supra*, at 948-56 (favoring the *Bjolmes* auction approach and noting that competing plans also give parties in interest an opportunity to bid); Markell, *supra*, at 121-23 (proposing that creditors be allowed to credit-bid their debts to check possible owner underbids); Lawrence B. Gutcho, *Real Estate Lenders and the Battle Over “New Value”*, 110 *Banking L.J.* 423, 436-38 (1993).

supra, § 4-4. At the very least, however, market discipline, with fair opportunity to bid or offer counterproposals, should be brought to bear.

B. THE PLAIN MEANING OF THE STATUTORY TEXT SHOULD BE HELD TO CONTROL CONSTRUCTION OF SECTION 1129(b).

The need for a consistent and principled approach to construction of the Code dictates a reversal of the decision below. Under Section 1129(b)(2), the “fair and equitable” requirement for confirming a plan by cramdown “includes” the stricture that a dissenting unsecured creditor class be paid in full or old equity “not receive or retain” any property “on account of” its prepetition interest. On its face, the Bankruptcy Code describes the absolute priority requirement of Section 1129(b)(2)(B)(ii) as a *minimum* requirement for cramdown plan confirmation. The word *includes*, which precedes the listing of confirmation requirements in Section 1129(b)(2), means that the courts can impose more requirements, not provide exceptions that eviscerate the minimum.²¹

Nevertheless, the court of appeals, relying on *Dewsnup*, 112 S. Ct. 773, found that the term “includes” in Section 1129(b)(2) “leaves room” for the addition of a new value exception to the stated rule. 2 F.3d at 912.

In *Dewsnup*, the Court stressed the primacy of pre-Code practice in construing the Code, noting that “[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate.” *Dewsnup*, 112 S. Ct. at 779 (citation omitted) (internal quotations

²¹ See *A.V.B.I.*, 143 B.R. at 743 (rejecting existence of new value exception); *Outlook/Century*, 127 B.R. at 656 (rejecting existence of new value exception).

omitted). *Dewsnup* advises lower courts to incorporate pre-Code bankruptcy concepts unless “convinced that Congress intended to depart from the pre-Code rule.” *Id.* at 778. The decision below relied heavily on *Dewsnup* to import a new value exception into Chapter 11. 2 F.3d at 912-13.²²

The court of appeals’ application of *Dewsnup* stands in stark contrast to *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), where the Court directed that “the plain meaning of legislation should be conclusive, except in the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.” *Id.* at 242 (internal quotation marks and citation omitted).²³

²² Other lower courts similarly have done so. See, e.g., *In re Snyder*, 967 F.2d 1126, 1129 (7th Cir. 1992) (dictum); *In re One Times Square Assocs. Ltd. Partnership*, 159 B.R. 695, 707 (Bankr. S.D.N.Y. 1993); *In re S.A.B.T.C. Townhouse Ass’n, Inc.*, 152 B.R. 1005, 1009 (Bankr. M.D. Fla. 1993).

²³ In urging the Court in *Ahlers* to rule that there is no new value exception the Solicitor General emphasized:

Nothing in the legislative history suggests a congressional intention to maintain the exception discussed in Los Angeles Lumber. The House report, in describing proposed Section 1129(b), states: “The general principle of the subsection permits confirmation notwithstanding non-acceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. The dissenting class must be paid in full before any junior class may share under the plan.” H.R. Rep. 95-595, *supra*, at 413. *No exceptions to this rule seem to be contemplated.*

Brief for the United States as *Amicus Curiae* Supporting Petitioners, *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (No. 86-958) (hereinafter “Solicitor General’s Brief in *Ahlers*”) at 21 (emphasis added) (footnotes omitted).

In general, the Court has embraced *Ron Pair*’s “plain meaning” approach to the statutory Code text. See Walter A. Effross, *Grammarians At The Gate: The Rehnquist Court’s Evolving “Plain Meaning” Approach to Bankruptcy Jurisprudence*, 23 Seton Hall L. Rev. 1636 (1993) (analyzing numerous cases); Robert K. Rasmussen, *A Study Of The Costs And Benefits Of Textualism: The Supreme Court’s Bankruptcy Cases*, 71 Wash. U.L.Q. 535 (1993). *Ron Pair* upholds “natural interpretation of the statutory language [that] does not conflict with any significant state or other federal interest, nor with any other aspect of the Code.” 489 U.S. at 245.

The court of appeals and other lower courts have not adequately focused on the danger of holding that old case law, arising under a different statutory scheme, should control interpretation of the Bankruptcy Code. Moreover, none of the cases cited in the court of appeals’ decision, including *Dewsnup* — a Chapter 7 case — analyzes, or even adverts to, the advisability of incorporating single elements of pre-Code reorganization law into the complex matrix of checks and balances that constitutes Chapter 11.

Chapter 11 was enacted in 1978 as a comprehensive overhaul of federal reorganization law. The three reorganization chapters of the old Bankruptcy Act of 1898, Chapter X (large business reorganizations), Chapter XI (small business reorganizations), and Chapter XII (real estate reorganizations), were combined into a single, new Chapter 11. 5 *Collier on Bankruptcy* (Lawrence P. King ed., 15th ed. 1993) (hereinafter “*Collier on Bankruptcy*”) ¶ 1100.01[2]. Overall, dramatic changes were made in business reorganization cases.

Significant differences existed among each of the reorganization chapters of the old Act, as well as between reorganization practice generally under the old Act and current Chapter 11 practice. For example, in old Chapter X the debtor

had no exclusive right to propose a plan.²⁴ Instead, all persons *other than* the debtor could submit proposals for a plan to the trustee, and the debtor could not file a plan until the trustee's time to file had expired. 5 *Collier on Bankruptcy* ¶ 1100.01[1]. In contrast, under new Chapter 11, the debtor has an exclusive period to file a plan and to obtain its acceptance. *See* 11 U.S.C. § 1121(b), (c).

Under Chapter X, a trustee, with power to operate the business and investigate all pertinent matters, was generally required, while in Chapter XI, the debtor generally was permitted to remain in possession of its property and to conduct its business. 5 *Collier on Bankruptcy* ¶ 1100.01[1]; *see A.V.B.I.*, 143 B.R. at 743. Under new Chapter 11, the debtor ordinarily is allowed to remain in possession. 11 U.S.C. §§ 1107, 1108.²⁵

In short, there was no singular pre-Code reorganization practice. Moreover, the new value exception arose in response to a problem under the old Act that does not arise under the Code. The Court's dicta in *Los Angeles Lumber*, 308 U.S. 106, out of which the discussion of new value arises, related to a "holdout" problem unique to the old Bankruptcy Act. Under the Act, a plan could be confirmed only if it was "fair and equitable" to *each dissenting creditor*. *See* Bankruptcy Act of 1898, Ch. X, § 221 (formerly codified as amended at 11 U.S.C. § 621 [1978]), *repealed by* Bankruptcy Code; Solicitor General's Brief in *Ahlers* at 14 n.13 (discussing old Chapter X and its predecessor, Section 77B). Not only was class acceptance required, but the

²⁴ Under old Chapter XI the debtor had the exclusive right to file a plan for the duration of the case. 5 *Collier on Bankruptcy* ¶ 1100.01[1].

²⁵ Chapter X had an absolute priority (fair and equitable) rule. However, absolute priority was deleted from Chapters XI and XII of the Act in 1952. Markell, *supra*, at 91-92; Stephen W. Sather & Adrian M. Overstreet, *The Single-Asset Real Estate Debtor: A Selective Overview*, 2 J. Bankr. L. Prac. 343-47 (1993).

plan had to observe absolute priority as to minority dissenting creditors of the same class. *Id.*

The present Code is different. The Bankruptcy Code permits a creditor class, by a class vote that overrides the objections of minority members, to assent to a plan that is not "fair and equitable," i.e., does not observe absolute priority. 11 U.S.C. § 1129(a)(8)(A). "Holdouts that spoiled reorganizations and created much of the motive for having judges 'sell' stock to the manager-shareholders no longer are of much concern, now that § 1126(c) allows the majority of each class (two-thirds by value) to give consent." *Kham & Nate's Shoes*, 908 F.2d at 1361.²⁶

"New value" cramdowns were not established pre-Code practice.²⁷ The new value concept arose from dicta, not holding, in *Los Angeles Lumber*. Despite that dicta, the Court has *never* adopted the new value exception in a case holding. As acknowledged in the decision below, prior to passage of the 1978 Code, the last time the new value exception was even adverted to by this Court was in 1946. 2 F.3d at 912. Commentators note that *no* reported decision adopted the *Los Angeles Lumber* dicta as holding prior to the Code's adoption in 1978. Markell, *supra*,

²⁶ Indeed, as noted by the Solicitor General in *Ahlers*, a substantial majority of bondholders had voted to accept the plan in *Los Angeles Lumber* and such bondholder consent would have been sufficient under the new Code consensually to confirm the plan under § 1129(a)(8)(A). Solicitor General's Brief in *Ahlers* at 14 n.13, 18 n.16.

²⁷ Epstein, Nickles and White observed in 1992:

This wall, the absolute priority rule, has protected reorganization creditors quite effectively against debtor onslaught for nearly 80 years. However, in the past decade debtors have successfully breached the wall in a handful of cases under the banner of "new value."

³ Epstein, *supra*, § 11-25.

at 92; John T. Bailey, *The "New Value Exception" in Single-Asset Reorganizations: A Commentary on the Bjolmes Auction Procedure and Its Relationship to Chapter 11*, 98 Com. L.J. 50, 54 (1993).

Holding pre-Code practice to be an overriding canon, warranting the incorporation of isolated pieces of pre-Code practice and dicta into the Bankruptcy Code, ultimately will result in havoc being played on the Chapter 11 statutory matrix. To the extent that *Dewsnup* is perceived to be a command to follow such a canon, it should be limited by this Court.

CONCLUSION

For the reasons stated above, the decision of the court of appeals should be reversed and the case remanded to the bankruptcy court for further proceedings consistent with this Court's ruling.

Respectfully submitted,

ROBERT B. MILLNER

(Counsel of Record)

LORIE A. CHAITEN

Sonnenschein Nath & Rosenthal

233 S. Wacker Drive

Suite 8000

Chicago, Illinois 60606-6404

(312) 876-8000

*Attorneys for Amici Curiae
American Council of Life
Insurance and Mortgage
Bankers Association of America*

Of Counsel:

RICHARD E. BARNSBACK

PHILLIP E. STANO

DAVID M. LEIFER

American Council of Life Insurance

1001 Pennsylvania Avenue, N.W.

Washington, D.C. 20004-2599

(202) 624-2183

WILLIAM E. CUMBERLAND

Mortgage Bankers Association of America

1125 Fifteenth Street, N.W.

Washington, D.C. 20005-2766

(202) 861-6516

SONNENSCHEIN NATH & ROSENTHAL

8000 SEARS TOWER

LOS ANGELES
NEW YORK
SAN FRANCISCO
ST. LOUIS
WASHINGTON, D.C.

CHICAGO, ILLINOIS 60606-6404

(312) 876-6000
TELEX 25-3526
FACSIMILE
(312) 876-7934

Lorie A. Chaiten
(312) 876-8936

February 14, 1994

VIA FEDERAL EXPRESS

Ford Elsaesser, Esq.
Elsaesser, Jarzabek, Buchanan
& Dressel
Lake Plaza Building
3rd and Lake Streets
Sandpoint, ID 83864

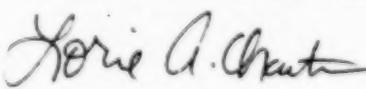
Re: U.S. Bancorp Mortgage Company v. Bonner Mall
Partnership

Dear Mr. Elsaesser:

Pursuant to Supreme Court Rule 37, I am writing to request your consent to the filing of a brief by The American Council of Life Insurance as amicus curiae in support of the Petitioner's position in the Supreme Court in the above-captioned matter. Please indicate your consent by signing on the line provided below. After you have done so, please return this document to me.

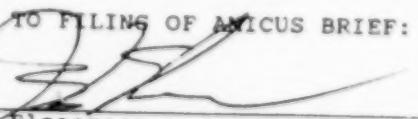
Very truly yours,

SONNENSCHEIN NATH & ROSENTHAL

By: 
Lorie A. Chaiten

LAC/kh

CONSENT TO FILING OF AMICUS BRIEF:

By: 
Ford Elsaesser
Counsel for the Debtor

RECEIVED

FEB 15 1994

STOEL RIVES BOLEY
JONES & GREY

(312) 876-8000

TELEX 25-3526

FACSIMILE

(312) 876-7934

SONNENSCHEIN NATH & ROSENTHAL

8000 SEARS TOWER

CHICAGO, ILLINOIS 60606-6404

LOS ANGELES
NEW YORK
SAN FRANCISCO
ST. LOUIS
WASHINGTON, D.C.

Robert B. Millner
(312) 876-7994

February 14, 1994

BY FEDERAL EXPRESS

Bradford Anderson, Esq.
Stoel Rives Boley Jones & Grey
3600 One Union Square
600 University St.
Seattle, WA 98101-3197

Re: U.S. Bancorp Mortgage Company v. Bonner
Mall Partnership

Dear Mr. Anderson:

Please confirm, by signing below, that Petitioner U.S. Bancorp Mortgage Company consents to the filing of an amicus curiae brief on the merits by the American Council of Life Insurance in the above-referenced case. Your consent should be returned to my attention.

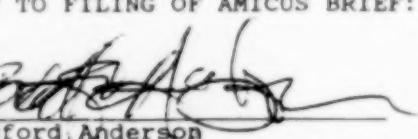
Very truly yours,

Robert B. Millner

Robert B. Millner
Counsel for American Council
of Life Insurance

RBM:jp

CONSENT TO FILING OF AMICUS BRIEF:

By: 
Bradford Anderson
Counsel of Record For Petitioner
U.S. Bancorp Mortgage Company

02/18/1994 16:22 FROM SONNENSCHEIN 1

TO

912082638759 P.02

SONNENSCHEIN NATH & ROSENTHAL

8000 BEARS TOWER
CHICAGO, ILLINOIS 60608-6404
TELE 31-3626
FACSIMILE
(312) 876-7934

LOS ANGELES 51 FEB 22 1994 30 NEW YORK

SAN FRANCISCO
ST. LOUIS
WASHINGTON, D.C.

(312) 876-8000
TELEX 29-3626
FACSIMILE
(312) 876-7934

Robert B. Millner
(312) 876-7934

76E

February 18, 1994

VIA FACSIMILE

Ford Elsaesser, Esq.
Elsaesser, Jarzabek, Buchanan
& Dressel
Lake Plaza Building
3rd and Lake Streets
Sandpoint, ID 83864

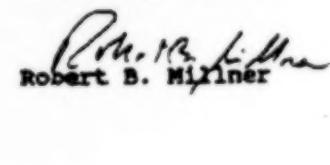
Post-It® Fax Note	7871	Date	2/22/94 10:59 AM
To	Louis Chaikin	From	FBI - Oklahoma City
Co.		Co.	
Phone #		Phone #	
Fax #	312-876-7934	Fax #	

Re: Bonner Hall

Dear Mr. Elsaesser:

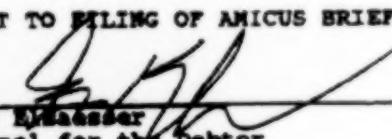
Pursuant to Supreme Court Rule 37, I am writing to request your consent to the filing of a brief by the Mortgage Bankers Association of America as *amicus curiae* in support of Petitioner's position in the Supreme Court in the above-captioned matter. Please indicate your consent by signing on the line provided below. After you have done so, please return this document to me by mail and facsimile.

Very truly yours,


Robert B. Millner

RBM/kh

CONSENT TO FILING OF AMICUS BRIEF:

By 
Ford Elsaesser
Counsel for the Debtor

TOTAL P.02

LT:BT 4881-22-20

TO: d

BEST AVAILABLE COPY

FEB 18 '94 15:43 STOEL RIVES BOLEY JONES & GREY P.2/2
TO 912063867500 P.02

SONNENSCHEIN NATH & ROSENTHAL

LOS ANGELES
NEW YORK
SAN FRANCISCO
ST. LOUIS
WASHINGTON, D.C.

6000 GEARY TOWER
CHICAGO, ILLINOIS 60609-6404

(312) 734-8000
TELEX 25 9825
FACSIMILE
(312) 734-7884

Robert B. Millner
(202) 554 7504

February 18, 1994

VIA FAXSIMILE

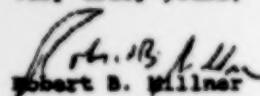
Bradford Anderson, Esq.
Stoel, Rives, Boley, Jones & Grey
One Union Square
400 University Street
36th Floor
Seattle, Washington 98101-3197

Re: Bonner Hall

Dear Bradford:

Pursuant to Supreme Court Rule 37, I am writing to request your consent to the filing of a brief by the Mortgage Bankers Association of America as *amicus curiae* in support of Petitioner's position in the Supreme Court in the above-captioned matter. Please indicate your consent by signing on the line provided below. After you have done so, please return this document to me by mail and facsimile.

Very truly yours,


Robert B. Millner

RBM/kh

CONSENT TO FILING OF AMICUS BRIEF:

By 
Bradford Anderson
Counsel for Mortgage Bankers
Association of America

TOTAL P.02

BEST AVAILABLE COPY

FEB 24 1994

No. 93-714

IN THE OFFICE OF THE CLERK

Supreme Court of the United States

OCTOBER TERM, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,
v.
BONNER MALL PARTNERSHIP,
Respondent.

On Writ Of Certiorari To The
United States Court Of Appeals
For The Ninth Circuit

BRIEF OF THE CALIFORNIA BANKERS ASSOCIATION |
THE NEW YORK STATE BANKERS ASSOCIATION AND
THE AMERICAN BANKERS ASSOCIATION
AS AMICI CURIAE
IN SUPPORT OF THE PETITIONER

Of Counsel:

CHRISTOPHER E. CHENOWETH
CALIFORNIA BANKERS ASS'N
455 Market Street, 17th Floor
San Francisco, CA 94105

MICHAEL F. CROTTY
AMERICAN BANKERS ASS'N
1120 Connecticut Avenue, NW
Washington, DC 20036

JONATHAN M. LANDERS*
KATHRYN A. COLEMAN
GREGORY J. CONKLIN
LINDA L. CURTIS
DESMOND J. CUSSEN
GIBSON, DUNN & CRUTCHER
1 Montgomery Street
San Francisco, CA 94104
(415) 393-8200

Attorneys for Amici Curiae
**Counsel of record*

QUESTION PRESENTED

The California Bankers Association and the American Bankers Association will address the following question raised by the Ninth Circuit Court of Appeals decision in *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership)*, 2 F.3d 899 (CA9 1993): whether "fair and equitable," as used in 11 U.S.C. § 1129(b), incorporates a "new value" doctrine so as to permit confirmation of a plan of reorganization which provides that existing equity owners will contribute "new value" to the reorganization and will own equity in the reorganized debtor, notwithstanding the rejecting vote of a class of unsecured creditors whose claims are not to be paid in full.

TABLE OF CONTENTS

	<u>Page</u>
INTEREST OF THE AMICI CURIAE	1
SUMMARY OF ARGUMENT	1
ARGUMENT.....	3
I. The Primary Pre-Code Use Of The New Value Rule Was To Deal With Dissenting Minority Creditors ...	3
A. Development Of The Absolute Priority Rule ...	3
B. Dissenters' Power And The Use Of The New Value Rule.....	5
II. The New Value Rule Is Inconsistent With The Statutory Scheme Of The Code	7
A. The Code Eliminates The "Holdout" Problem ..	7
B. The New Value Rule Is Contrary To The Policies Underlying The Code	8
C. Application of the New Value Rule Disrupts The Code's Careful Balancing of Interests	10
III. The Court Of Appeals' Policy Rationale Is Inconsistent With The Code, And The "Standards" For The New Value Rule Are Difficult To Apply.....	13
A. The Court Of Appeals' Policy Rationale Is Inconsistent With The Code	13
B. The Courts' Difficulty In Applying The New Value Rule Demonstrates Its Infirmities	16
IV. The New Value Rule Delays Resolution, Distorts Priorities, Increases the Costs of Reorganizations, And Makes Credit More Expensive And More Scarce ...	18
A. The Code Adopts Specific Distribution Rules Which Allocate Ownership of Insolvent Entities To Their Creditors	18

TABLE OF CONTENTS

	<u>Page</u>
B. Recognition Of A New Value Rule Adversely And Unjustifiably Affects the Lending Process ..	20
1. The Impact Of The New Value Rule	20
2. The Stated Rationales For The New Value Rule Are Specious	23
3. Summary.....	26
V. The Plain Meaning Principle Precludes Recognition Of A New Value Rule	26
A. Language Of Section 1129(b)(2).....	27
B. The Court Of Appeals Misread The "On Account Of" And "Includes" Language Of Section 1129 ..	27
C. The Court Of Appeals Misinterpreted <i>Dewsnup</i> And <i>Davenport</i> To Create A Rule Overly Deferential to Pre-Code Practice	28
D. The Legislative History Shows That Congress Rejected The New Value Rule.....	29
CONCLUSION.....	30

TABLE OF AUTHORITIES

CASES

	<u>Page</u>
<i>Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.</i> , 2 F.3d 899 (CA9 1993), cert. granted, 126 L.Ed.2d 648 (1994)	13, 16, 27, 28, 29, 30
<i>Case v. Los Angeles Lumber Prods. Co.</i> , 308 U.S. 106 (1939)	5, 6, 20
<i>Chicago, R.I. & P.R.R. v. Howard</i> , 7 Wall. (74 U.S.) 392 (1988)	4
<i>Consolidated Rock Prods. Co. v. DuBois</i> , 312 U.S. 510 (1941)	6
<i>Dewsnup v. Timm</i> , 112 S. Ct. 773 (1992)	26, 28, 29
<i>Ecker v. Western Pacific R.R.</i> , 318 U.S. 448 (1943)	5
<i>FDIC v. Sea Pines Co.</i> , 692 F.2d 973 (CA4 1982), cert. denied, 461 U.S. 928 (1983)	20
<i>General Stores Corp. v. Shlensky</i> , 350 U.S. 462 (1956) ...	6
<i>Great W. Life Ins. Co. v. Pine Gate Assocs., Ltd.</i> , 2 B.C.D. 1478 (Bankr. N.D. Ga. 1977)	12
<i>Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R.R.</i> , 318 U.S. 523 (1943)	6
<i>In re Aztec Co.</i> , 107 B.R. 585 (Bankr. M.D. Tenn. 1989) ..	17
<i>In re Bryson Properties, XVIII</i> , 961 F.2d 496 (CA4 1992), cert. denied, 113 S. Ct. 191 (1992)	22
<i>In re California Hancock, Inc.</i> , 88 B.R. 226 (Bankr. CA9 1988)	17
<i>In re Greystone III Joint Venture</i> , 995 F.2d 1274 (CA5 1991), corrected, reinstated, reh'g denied, 995 F.2d 1284 (CA5 1991) (Jones J., dissenting), cert. denied, 113 S. Ct. 72 (1992)	21, 22, 23
<i>In re Henke</i> , 90 B.R. 451 (Bankr. D. Mont. 1988)	16
<i>In re Montgomery Court Apartments</i> , 141 B.R. 324 (Bankr. S.D. Ohio 1992)	17

TABLE OF AUTHORITIES

CASES

	<u>Page</u>
<i>In re Mortgage Inv. Co. of El Paso</i> , 111 B.R. 604 (Bankr. W.D. Tex. 1990)	17
<i>In re Potter Material Serv., Inc.</i> , 781 F.2d 99 (CA7 1986)	16
<i>In re Public Serv. Co.</i> , 88 B.R. 521 (Bankr. D.N.H. 1988)	20
<i>In re Snyder</i> , 967 F.2d 1126 (CA7 1992)	16
<i>In re Sovereign Group, 1985-27, Ltd.</i> , 142 B.R. 702 (E.D. Pa. 1992)	17
<i>In re Tampa Bay Assoc., Ltd.</i> , 864 F.2d 47 (CA5 1989) ..	12
<i>In re U.S. Truck Co.</i> , 800 F.2d 581 (CA6 1986)	18
<i>In re Yasparro</i> , 100 B.R. 91 (Bankr. M.D. Fla. 1989)	16
<i>Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting</i> , 908 F.2d 1351 (CA7 1990)	16, 20, 21, 23
<i>Lebold v. Inland Steel Co.</i> , 125 F.2d 369 (CA7 1941), cert. denied, 316 U.S. 675 (1942)	14
<i>Louisville Trust Co. v. Louisville, New Albany & Chicago Ry.</i> , 174 U.S. 674 (1899)	4, 5
<i>Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.</i> , 317 U.S. 78 (1942)	6
<i>Mason v. Paradise Irr. Dist.</i> , 326 U.S. 536 (1946)	7
<i>NLRB v. Bildisco & Bildisco</i> , 465 U.S. 513 (1984)	14
<i>Northern Pac. Ry. v. Boyd</i> , 228 U.S. 482 (1913)	4, 6, 20
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1988)	10, 14, 16, 28
<i>Patterson v. Shumate</i> , 112 S. Ct. 2242 (1992)	26
<i>Pennsylvania Public Welfare Dept. v. Davenport</i> , 495 U.S. 552 (1990)	26, 28, 29
<i>Perlman v. Feldman</i> , 219 F.2d 173 (CA2 1955)	20
<i>Toibb v. Radloff</i> , 111 S. Ct. 2197 (1991)	26

TABLE OF AUTHORITIES

CASES

	<u>Page</u>
<i>Union Bank v. Wolas</i> , 112 S. Ct. 527 (1991).....	26
<i>United States v. Ron Pair Enters., Inc.</i> , 489 U.S. 235 (1989)	26, 28

STATUTES

	<u>Page</u>
11 U.S.C. Section 101	1
11 U.S.C. Section 101(11)	29
11 U.S.C. Section 102(3)	28
11 U.S.C. Section 361	15, 27
11 U.S.C. Section 363	15
11 U.S.C. Section 363(k)	10, 17
11 U.S.C. Section 506(d)	28, 29
11 U.S.C. Section 522	29
11 U.S.C. Section 541(c)(2)	26
11 U.S.C. Section 552(b)	27
11 U.S.C. Section 722	29
11 U.S.C. Section 1104	15
11 U.S.C. Section 1111(b)	12
11 U.S.C. Section 1111(b)(1)(B)(ii)	10
11 U.S.C. Section 1112(b)(2)	15
11 U.S.C. Section 1121(d)	15
11 U.S.C. Section 1123(a)(5)(D)	15
11 U.S.C. Section 1126(c)	10
11 U.S.C. Section 1126(e)	23
11 U.S.C. Section 1129	12
11 U.S.C. Section 1129(a)(10)	22

TABLE OF AUTHORITIES

STATUTES

	<u>Page</u>
11 U.S.C. Section 1129(b)	2, 3, 15, 17, 18, 19, 20, 22, 23, 24, 25, 26, 27, 28, 29, 30
11 U.S.C. Section 1129(b)(2)	27, 28
11 U.S.C. Section 1129(b)(2)(iii)	15
11 U.S.C. Section 1129(b)(2)(B)(ii)	9, 27, 29
11 U.S.C. Section 1129(c)	25
11 U.S.C. Section 1141(d)(3)	15
Act of July 1, 1898, ch. 541, 30 Stat. 544 (1898), as amended (repealed October 1, 1979) (the "Act")	2
Act of March 3, 1933, Ch. 204, § 77, 47 Stat. 1467, 1474 (1933)	4, 5, 6
Act of June 7, 1934, Ch. 424, § 77B, 48 Stat. 911, 912 (1934)	4, 5, 6

PROPOSED LEGISLATION

S. 540, 103d Cong., 1st Sess. § 102 (1993)	20
--	----

LEGISLATIVE HISTORY

Bankruptcy Comm'n of the United States, <i>1 Report of the Comm'n on the Bankruptcy Laws of the United States</i> , H.R. Doc. 137, 93d Cong., 1st Sess. 256 (1973) ("Commission Report")	8, 11, 30
H.R. Rep. 595, 95th Cong., 1st Sess. 220-241 (1977) ("House Report")	11, 12, 29

OTHER AUTHORITIES

ALI-ABA Conference, <i>Bankruptcy Reform Circa 1993, A Presentation of the National Bankruptcy Conference's Bankruptcy Code Review Project 253-55 (1993)</i>	25
Ayer, <i>Rethinking Absolute Priority After Ahlers</i> , 87 Mich. L. Rev. 963 (1989) ("Ayer")	4, 6

TABLE OF AUTHORITIES

OTHER AUTHORITIES

Page

Blum & Kaplan, <i>The Absolute Priority Doctrine in Corporate Reorganizations</i> , 41 U. Chi. L. Rev. 651 (1974) ("Blum & Kaplan")	14, 19, 30
6A Collier on Bankruptcy, ¶ 11.06 (14th ed. 1978)	4
9 Collier on Bankruptcy, ¶ 9.18 (14th ed. 1978)	11
Klee, <i>All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code</i> , 53 Am. Bankr. L.J. 133 (1979)	9
Klee, <i>Cram Down II</i> , 64 Am. Bankr. L.J. 229 (1990)	6
12B Fletcher Cyc. Corp. § 5811 (Perm. Ed.)	14
LoPucki & Whitford, <i>Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large Publicly Held Companies</i> , 139 U. Pa. L. Rev. 125 (1990)	20
LoPucki, <i>The Trouble With Chapter 11</i> , 1993 Wis. L. Rev. 729 (1993) ("LoPucki")	19, 20, 21, 22
LoPucki & Whitford, <i>Preemptive Cram Down</i> , 65 Am. Bankr. L.J. 625 (1991)	21
Markell, <i>Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations</i> , 44 Stan. L. Rev. 69 (1991) ("Markell")	4, 8, 17, 21, 23
Note, <i>The Bankruptcy Code and the New Value Doctrine: An Examination into History, Illusions, and the Need for Competitive Bidding</i> , 79 U. Va. L. Rev. 917 (1993)	21, 25
Skeel, <i>The Uncertain State of an Unstated Rule: Bankruptcy's Contribution Rule After Ahlers</i> , 63 Am. Bankr. L. J. 221 (1989)	23
Warren, <i>A Theory of Absolute Priority</i> , 1991 Annual Survey of American Law 9 (1991)	24

No. 93-714

IN THE
Supreme Court of the United States

OCTOBER TERM, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,

v.

BONNER MALL PARTNERSHIP,
*Respondent.*On Writ Of Certiorari To The
United States Court Of Appeals
For The Ninth CircuitBRIEF OF THE CALIFORNIA BANKERS ASSOCIATION
THE NEW YORK STATE BANKERS ASSOCIATION AND
THE AMERICAN BANKERS ASSOCIATION
AS AMICI CURIAE
IN SUPPORT OF THE PETITIONER

INTEREST OF THE AMICI CURIAE

The California Bankers Association ("CBA") and the American Bankers Association ("ABA") jointly file this brief as *amici curiae* in support of Petitioner U.S. Bancorp Mortgage Company.*

Amici are associations that represent banks in California and across the country. The CBA is the principal trade association for the lending industry in California. It represents virtually all of the commercial banks and trust companies in California. The ABA is the principal trade association for the commercial banking industry in the United States. It represents commercial banks of all types and sizes in each of the fifty states and the District of Columbia. Together, ABA member banks represent approximately ninety percent of the assets of the nation's banks.

This appeal is of vital interest to the CBA, the ABA and their member banks. This Court's decision will have wide-ranging legal and practical consequences for virtually every lender in the United States. The determination whether the owners of businesses in chapter 11 may retain their equity interests by contributing "new value," but without paying objecting creditors in full, will affect not only lenders' litigation and negotiation strategies in bankruptcy cases but their actions in making new loans and working out troubled loans as well.

This brief is filed pursuant to Rule 37.3 of the Rules of this Court. The parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of this Court.

* See Addendum 1

SUMMARY OF ARGUMENT

The new value rule¹ has never been more than a theoretical construct. The rule originated in a Supreme Court *dictum* that pre-dated the current bankruptcy code² by almost fifty years and

¹ Although there is some controversy over the proper terminology, *amici* will simply refer to the concept as the "new value rule."

² 11 U.S.C. §§ 101 *et seq.*, as amended (hereinafter "Code"). All "Section" references herein are to the Code unless specified otherwise.

was virtually unused under pre-Code law.³ To the extent that there was a new value rule under the Act, its purpose was to protect majority creditors from the harsh results that sometimes attended the absolute priority rule, namely allowing even a single creditor to block confirmation of a plan accepted by the majority.

With the enactment of the Code, any new value rule that even theoretically existed under the Act was abolished.⁴ The Code has complex rules for allocating reorganization value, requiring that each class of unsecured creditors receive "fair and equitable" treatment in accordance with the absolute priority rule (unqualified by any new value rule); alternatively, a class can consent to alternative treatment by specific majority vote, and thereby bind dissenters. The Code thus eliminates the intra-creditor conflict that gave rise to the new value rule. Under the Act, the new value rule was used as a weapon by majority creditors against dissenters; under the Code, its only use is by owners against majority creditors.

The new value rule upsets the Code's careful balance among secured creditors, senior and junior unsecured creditors and owners, which is apparent throughout chapter 11. The new value rule also undermines an important philosophic premise of the Code, which is to substitute negotiation and class voting for judicial resolution of competing interests. The Code does not give courts the power to change the rules on general equitable grounds.

As a matter of policy, the new value rule is highly costly and disruptive. Since virtually all debtors are insolvent, the costs of bankruptcy fall almost entirely on creditors. The rule delays resolution of bankruptcy cases (by giving owners an incentive for strategic delay), gives additional leverage to owners, increases transaction costs (by substituting a vague standard for the specific

³ Act of July 1, 1898, ch. 541, 30 Stat. 544 (1898), as amended (repealed October 1, 1979) (hereinafter "Act").

⁴ Because the parties have briefed the relevant issues of statutory interpretation at length, *amici* will focus primarily upon the historical and policy basis for a clear absolute priority rule as codified in 11 U.S.C. § 1129(b).

legal rule of Section 1129(b)), and leads to transfers of reorganization value from creditors, where Congress has said it belongs, to existing owners. In short, the new value rule distorts priorities set by Congress, prolongs cases, and inevitably increases the cost of credit.

ARGUMENT

I. The Primary Pre-Code Use Of The New Value Rule Was To Deal With Dissenting Minority Creditors.

There is no new value rule in the Code, and it is not seriously argued that the rule should be recognized on its own merits. Instead, proponents argue that it was a settled doctrine under pre-Code law that should be read into the Code. In this Part, *amici* show that the historical underpinnings of the rule are dubious at best, and that the rule was not such a well-established feature of pre-Code law that it should be deemed incorporated into a new and radically different statutory scheme.

A. Development Of The Absolute Priority Rule.

In the late nineteenth and early twentieth centuries, spurred by the widespread failure of America's railroads, the focus of bankruptcy law began to change from liquidation to reorganization. What is now universally referred to as the "absolute priority rule" — *i.e.*, that a debtor's creditors must be paid in full before its owners may retain value — developed in the context of the first railroad reorganizations, which were accomplished through equity receiverships.

These early reorganizations often centered around "friendly foreclosure" arrangements between secured creditors and owners which had the effect of transferring the debtor's assets to a new entity (encumbered by all or some of the old secured debt), leaving unsecured creditors with nothing more than a shell from which to seek collection of the amounts owed them, and enabling owners to retain the assets and going concern value of the

reorganized enterprise.⁵ The absolute priority rule developed in response to unsecured creditors' complaints that these early arrangements improperly eliminated their rights.⁶

The first step in the formulation of the absolute priority rule was to permit unsecured creditors to challenge these receivership transactions based on the distinction between a typical mortgagor/mortgagee foreclosure (which eliminates all inferior claims) and these "friendly" foreclosures (which eliminated junior creditors' rights but allowed owners to retain an interest after the foreclosure).⁷ Then, courts turned to consider the exact scope of those rights. In the landmark case of *Northern Pac. Ry. v. Boyd*, 228 U.S. 482 (1913), this Court struck a balance among the desirability of continuing to operate a railroad, the need for funds to do so (recognizing owners as the most likely source of those funds), and the unsecured creditors' rights by articulating a standard which required a "fair offer" to unsecured creditors.

After *Boyd*, two competing definitions of "fair offer" were suggested: a rule of "absolute priority" which recognized state law claims and did not permit owners to participate in the reorganized debtor unless those claims were satisfied in full, and a rule of "relative priority" which permitted owners to participate if earnings met certain levels and relative priorities among classes were observed.⁸ In 1933 and 1934 Congress entered the fray by adding Sections 77 and 77B to the Act. While Sections 77 and 77B were

not identical,⁹ they both required that plans be fair and equitable as to each creditor and that all classes of affected creditors accept the plan by the required class vote.

The conflict between the relative priority and the absolute priority "camps" finally reached this Court in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939). In *Case*, this Court considered whether "fair and equitable" as used in Section 77B of the Act embodied the concept of relative or absolute priority. This Court ruled that both majority creditor consent and a determination that the plan was fair and equitable were required for confirmation. It then held that the statute's use of the term "fair and equitable" incorporated the absolute priority approach, and thereby effectively ended the absolute priority versus relative priority debate.

B. Dissenters' Power And The Use Of The New Value Rule.

Sections 77 and 77B of the Act provided unsecured creditors with the right to vote by class on reorganization plans and required that a reorganization plan be fair and equitable as to *each* creditor, thus permitting an outvoted class member to block confirmation of a plan by convincing the court that the plan was not fair and equitable. But because absolute priority had prevailed in *Case*, the new rule lacked the flexibility that had been present in equity receiverships. Given the need for capital, the available sources of such capital, and the leverage of dissenting creditors, and faced with a strict absolute priority requirement, the courts struggled to fashion a rule that would recognize "certain practical considerations,"¹⁰ *Case*, 308 U.S. at 117, and allow confirmation

⁵ See Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 78-80 (1991) (hereinafter "Markell"); Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963 (1989) (hereinafter "Ayer").

⁶ See, e.g., *Louisville Trust Co. v. Louisville, New Albany & Chicago Ry.*, 174 U.S. 674, 689 (1899).

⁷ See, e.g., *Louisville Trust Co.*, 174 U.S. at 683-84; *Chicago, R.I. & P.R.R. v. Howard*, 7 Wall. (74 U.S.) 392 (1868).

⁸ See Markell at 82. See also 6A Collier on Bankruptcy, ¶ 11.06 (14th ed. 1978).

⁹ Section 77, providing for railroad reorganizations, was enacted in 1933 (Act of March 3, 1933, Ch. 204, § 77, 47 Stat. 1467, 1474 (1933)); Section 77B applied to other kinds of corporations and was enacted in 1934 (Act of June 7, 1934, Ch. 424, § 77B, 48 Stat. 911, 912 (1934)).

¹⁰ The problem was particularly acute for railroads, where significant public interests were at stake. See, e.g., *Louisville Trust Co.*, 174 U.S. at 682; *Ecker v. Western Pac. R.R.*, 318 U.S. 448 (1943).

of plans without "requir[ing] the impossible." *Boyd*, 228 U.S. at 508. Perhaps recognizing the dilemma, in *Case*, this Court stated in *dicta* that owners could under some circumstances participate in a plan, but only "based on a contribution in money or money's worth, reasonably equivalent in view of all circumstances to the participation of the stockholder," and only if "it satisfactorily appears that full recognition has been given to the value of creditors' claims," 308 U.S. at 121, 122 — a test that was not met by the *Case* owners, whose proposed contributions were intangible.

Thus, this Court's first statement of the new value rule was in *dicta*, gave no guidance as to the actual conditions under which it might be applied, and did not discuss how the new value rule could coexist with the absolute priority rule. No subsequent pre-Code decisions of this Court upheld as fair and equitable a plan providing for owner participation where senior claims were not satisfied in full.¹¹ In fact, there appear to be no published decisions under the Act adopting the rationale set forth in the *Case* *dictum* to confirm a new value plan over the objection of a dissenting creditor.¹²

It is critical to note, however, that whatever new value rule may have existed after enactment of Sections 77 and 77B of the Act could never be used to confirm a plan over the objection of an entire class of creditors, since it was a concurrent requirement that all classes accept the plan by a two-thirds majority. Act §§ 77B(e)(i), 77B(f). Thus, the only purpose of a new value rule under the Act after enactment of Sections 77 and 77B of the Act was to permit, in certain obviously extraordinary, but undefined,

¹¹ See *Consolidated Rock Prods. Co. v. DuBois*, 312 U.S. 510 (1941); *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, 317 U.S. 78 (1942); *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R.R.*, 318 U.S. 523 (1943). The more often litigated issue was the choice between chapter X and chapter XI (which did not contain a rigorous absolute priority rule). See, e.g., *General Stores Corp. v. Shlensky*, 350 U.S. 462, 465-66 (1956).

¹² See Ayer at 1016. See also Klee, *Cram Down II*, 64 Am. Bankr. L.J. 229, 241 (1990).

circumstances, confirmation of a plan accepted by a two-thirds majority vote of each class of creditors, and to bind dissenters notwithstanding the absolute priority rule.¹³

II. The New Value Rule Is Inconsistent With The Statutory Scheme Of The Code.

Given the weak historical antecedents of the new value rule, the Court of Appeals' conclusion that it was an established pre-Code bankruptcy practice, which Congress did not indicate an intention to change, seems strained. Any lingering doubt is resolved by examining the provisions and structure of the Code itself, which clearly preclude recognition of a new value rule.

A. The Code Eliminates The "Holdout" Problem.

The Code's provisions for class voting and the application of the fair and equitable standard literally reversed the statutory scheme of the Act. Under the Act, any class vote rejecting the plan was outcome-determinative, while an affirmative class vote triggered application of the fair and equitable rule as to each creditor in the class. Conversely, under the Code, a class vote accepting the plan is outcome-determinative, and a class rejection triggers application of the fair and equitable requirement to the class as a whole.

The new value rule as applied under the Act was, in essence, a creditor protection for the majority against the minority, only invoked to override dissenters from an affirmative majority vote. Because of the way the Code's voting provisions work, the absolute priority rule no longer requires the "impossible": any plan that could have been confirmed under the Act, by using the new value rule to override the objections of outvoted minority creditors, would by definition be confirmable under the Code with

¹³ See, e.g., *Mason v. Paradise Irr. Dist.*, 326 U.S. 536 (1946) (upheld confirmation of plan whereby "new value" was provided by a creditor). While the Ninth Circuit cited *Mason* in support of confirming a new value plan providing for owner participation, 2 F.3d 899 at 906, *Mason* in fact involved new value being provided by a bondholder, this Court having upheld the ICC's determination that there was no value to support owner participation.

no need for a new value rule and without reference to the fair and equitable standard. Thus, the Code eliminates the possibility that dissenters will have the power to stymie confirmation — which is exactly the problem solved by the new value rule. The complementary goals of giving effect to the wishes of the majority of creditors, and of having a mechanism to override dissenters, are met by the workings of the Code itself, and the new value rule is superfluous.

B. The New Value Rule Is Contrary To The Policies Underlying The Code.

The new value rule is not, however, merely a harmless holdover from pre-Code days. Importing the Act's new value rule into the radically different statutory scheme of the Code vitiates the underlying policies of the Code, creates results that are different from, and sometimes diametrically opposed to, the results obtained by using the new value rule under the Act, and skews the debtor-creditor balance struck by the provisions of the Code.

The provisions of chapter 11 of the Code represent Congress' choice of creditor decisionmaking over judicial supervision. At the time the Code was being crafted, the judicial supervision model was articulated in the proposal that courts be permitted to override creditors' objections to plans which were found to be fair and equitable, without more precise standards, Markell at 89, and in the Bankruptcy Commission's proposal to permit owners to retain value under conditions to be applied by the court.¹⁴ The judicial supervision model can also be found in both chapters 12 and 13 of the Code, which dispense with any requirement that creditors approve plans under those chapters.

The Code minimizes the discretionary aspect of plan confirmation under chapter 11. Majority approval of a plan by a class is both necessary and sufficient for confirmation as to that class, without either the need for court involvement or the possibility that the court will override the majority's choice. Making creditor

choice outcome-determinative in many situations, which in turn allows creditors to waive the benefits of the absolute priority rule, was one of the innovations of the Code,¹⁵ and is entirely consistent with the goals served by the new value rule.

In the limited situations under the Code where the bankruptcy court may review creditors' choices with respect to plans of reorganization, as when the majority of creditors in a class rejects a plan and the plan proponents request confirmation notwithstanding such rejection, the statute sets forth clearly-stated and easily-applied rules for the court to follow. Thus, pursuant to Section 1129(b)(2)(B)(ii), there are two choices: full payment or no value to junior classes. The facts necessary for the court to make the required analysis are easily available and readily interpreted; moreover, it is easy to understand Congress' motivation in permitting the court to override the creditors' rejection of the plan if either of these requirements is met. Where full payment is offered, a rejecting vote is likely to be motivated by something other than economics; where full payment is not forthcoming but no junior class will receive value, creditors will effectively receive all available value and their state law rights and priorities are being preserved.

Allowing use of the new value rule to override the majority creditors' rejection of a plan is another matter entirely. First, the rule departs from the Code by expanding the circumstances in which the court can override the creditors' choice. Second, it does so using a factually difficult, nebulous test that bears no resemblance to the bright-line standards set forth in Section 1129(b)(2)(B)(ii). In effect, recognizing a new value rule under the Code strips creditors of the ability to choose their treatment and allows the judge to sell the equity of the reorganized enterprise to the existing owners, at a price determined by the owners — a situation reminiscent of the equity receivership transactions which resulted in the purchase of assets by existing owners for less than the debt encumbering them. The Code does not contemplate forced sales in analogous circumstances, at least not without

¹⁴ Bankruptcy Comm'n of the United States, 1 *Report of the Comm'n on the Bankruptcy Laws of the United States*, H. R. Doc. 137, 93d Cong., 1st Sess. 256 (1973) (hereinafter "Commission Report").

¹⁵ See Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133, 143 (1979).

affording creditors the right to credit bid at the sale. See, e.g., 11 U.S.C. §§ 363(k), 1111(b)(1)(B)(ii).

This Court has already made clear that the creditors', not the bankruptcy courts', choice governs. In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988), where farm debtors argued that creditors would be better off with a plan permitting the debtors to retain their interests in exchange for future work, this Court stated that:

The Court of Appeals may well have believed that petitioners or other unsecured creditors would be better off if [the debtors'] plan was confirmed. But that determination is for the creditors to make in the manner specified by the Code. 11 U.S.C. § 1126(c). Here, the principal creditors entitled to vote in the class of unsecured creditors . . . objected to the proposed reorganization. This was their prerogative under the Code, and courts applying the Code must effectuate their decision.

Most importantly, however, use of the new value rule under the Code stands the original purpose of the rule on its head. Under the Act, since there was no power to override the vote of a dissenting class, the rule could only be used as a weapon by majority creditors against the minority; it was a creditor's right. Under the Code, the only possible use for the rule is as a weapon by owners against dissenting classes of creditors. Neither this Court nor any other court has recognized, approved of, or even adverted to, the use of the rule for such a purpose.

C. Application Of The New Value Rule Disrupts The Code's Careful Balancing Of Interests.

Chapter 11 of the Code represents a complex compromise among competing concerns: the rehabilitation of debtors, the rights of secured creditors, and the rights *inter se* of senior and junior creditors and owners. This compromise was designed to balance different parties' relative strengths in negotiating the plan and to identify parameters for that negotiation. Recognition of the new value rule undermines both the compromise and the legislation.

First, the separate provisions of chapters X and XI of the Act were combined to create chapter 11 of the Code, with a single standard for confirming plans.¹⁶ The absolute priority rule, which existed under chapter X but not chapter XI,¹⁷ is incorporated into the new standard, but can be modified by class vote. Owners cannot preserve their interests without paying creditors in full, which they could do under chapter XI; however, they can preserve their interests, regardless of whether creditors are fully paid, if a majority of creditors within each class approves. As a result, when plans are negotiated owners have to convince creditors that their proposed contribution justifies whatever interest they seek to retain. Recognition of the new value rule under the Code negates this result, because it gives owners a second audience; they can appeal to the court if they fail to convince creditors.

Second, chapter 11 allows debtors to remain in possession, which reconciles former chapter X and the Bankruptcy Commission's recommendation,¹⁸ both of which provided for the appointment of trustees in every case, with former chapter XI, which left the debtor in possession. Under the Act, where an independent trustee was appointed in every significant chapter X case, recognition of a new value rule did not raise the issues of conflicts of interest, breach of duty and collusion. Under the Code, though, recognition of the rule does raise these issues, and vitiates the compromise.

Third, under chapter 11 debtors are afforded a limited period of time, which may be extended, in which they have the exclusive right to propose and confirm a plan of reorganization. This provision was enacted not in an effort to give the debtor a special ability to impose a new value plan over the objection of a

¹⁶ H.R. Rep. 595, 95th Cong., 1st Sess. 220-241 (1977) (hereinafter "House Report").

¹⁷ The "fair and equitable" language was repealed in 1952 because chapter XI "compositions" contemplated continued equity participation in the reorganized business. See generally 9 Collier on Bankruptcy, ¶ 9.18 (14th ed. 1978).

¹⁸ Commission Report at 240.

dissenting class of creditors, but in the hope that the debtor's draft plan would be a focal point for negotiations. House Report at 231-232. A new value rule is inconsistent with the Code's exclusivity provisions.

Fourth, Section 1129 carefully balances the rights of dissenters by permitting a class vote to override minority creditors, but specifying the treatment of dissenting classes. There is no new value rule or other equitable principle available to junior creditors vis-a-vis dissenting senior creditors. It seems anomalous, therefore, to give owners a unique, *de facto*, cramdown power over classes senior to them through application of the new value rule.

Fifth, recognition of the new value rule undermines rights which Congress gave real property lenders pursuant to Section 1111(b), which was a response to the bankruptcy court's decision in *Great W. Life Ins. Co. v. Pine Gate Assocs., Ltd.*, 2 B.C.D. 1478 (Bankr. N.D. Ga. 1977). *Pine Gate* permitted confirmation of a plan which paid a real estate lender the appraised value of its collateral and preserved the existing owners' interests. Congress enacted Section 1111(b) to ensure that undersecured real estate lenders, whether or not they would have a deficiency claim under state law, have a deficiency claim in chapter 11 which can be voted against a new value plan. See *In re Tampa Bay Assoc., Ltd.*, 864 F.2d 47 (CA5 1989). Recognition of a new value rule under the Code undermines this protection, and revives the result Congress sought to eradicate, by permitting confirmation of *Pine Gate*-type plans which reduce the secured creditor's claim to the appraised value of the property, make minimal distributions to unsecured creditors, and allow owners to retain their interests.

The new value rule distorts the dynamics of the central compromise that shaped chapter 11 of the Code. The rule negates unsecured creditors' principal protection under the Code: the assurance that if they are not to be paid in full, they will at least receive all the reorganization value there is to be had.

III. The Court Of Appeals' Policy Rationale Is Inconsistent With The Code, And The "Standards" For The New Value Rule Are Difficult To Apply.

The Court of Appeals failed to articulate exactly why there should be a new value rule and how the purported standards for its use should be applied. Neither failure is surprising: no discernible bankruptcy policy is served by a new value rule, and it is difficult to apply vague standards in a vacuum.

A. The Court Of Appeals' Policy Rationale Is Inconsistent With The Code.

As discussed above, the new value rule was originally justified by the need to preserve going concern value, the rigor of the absolute priority rule and the disproportionate power of minority dissenting creditors to disrupt the process. Perhaps recognizing that this rationale is inapplicable under the Code, the Court of Appeals suggested that the bankruptcy courts' overriding goal should be the rehabilitation of distressed businesses as going concerns; the court cited the difference between going concern and liquidation value, the importance of maintaining jobs and the need to minimize an adverse effect on the businesses of suppliers and customers and "the economy as a whole," 2 F.3d at 916. Implicit in this approach is that the bankruptcy court has significant discretion in achieving the goal of reorganization, and this premise is at the heart of the opinion below: "[p]roperly applied, the new value exception allows bankruptcy courts to fulfill their assigned role of balancing the interests of debtors, creditors, old owners, and the public, guided by the overriding goal of ensuring the success of the reorganization." 2 F.3d at 917.

Closer examination proves that the Ninth Circuit's policy rationale is ephemeral. First, it is difficult to relate to the typical post-Code cases implicating the rule — which involve single-asset real estate partnerships, farms and small corporations. Concerns about minimizing disruption of the economy do not apply in these cases, and job loss is unlikely in real estate, and at least some farm, cases. Moreover, in cases involving businesses large enough for the rationale to apply, the very nature of the new value rule virtually precludes its use. For debtors whose ownership is widely

or publicly held, participation by all owners is impracticable, and any plan which attempts to limit participation to some but not all owners raises issues of securities law requirements and fiduciary obligations. *Lebold v. Inland Steel Co.*, 125 F.2d 369 (CA7 1941), *cert. denied*, 316 U.S. 675 (1942); 12B *Fletcher Cyc. Corp.* § 5811 (Perm. Ed.).

More significantly, the Court of Appeals' rationale is one that Congress did not adopt. While there certainly are Congressional statements, and language in decisions of this Court, that describe a policy in favor of reorganization, those statements merely describe the provisions of chapter 11 of the Code.¹⁹ They do not form the basis for some additional judicial power to confirm plans on policy grounds. Professors Blum and Kaplan cautioned against such an open-ended power as follows:

The trouble with conferring this wide discretion on the reorganization judge is patent. A chief concern behind the adoption of the absolute priority doctrine was to prevent junior investors from gaining participation in a reorganized entity by trading on the nuisance value of otherwise worthless claims. Explicit authorization of judicial discretion would again legitimate and encourage that technique. A mass of experience reveals that courts have generally been prone to accept compromises in order to expedite termination of lengthy proceedings over complicated corporate financial matters and to avoid having to make and carry out hard decisions. Nothing suggests that this temptation will be less in the future.²⁰

Notwithstanding that Congress was clearly aware that it had the option of articulating a policy favoring reorganization,²¹ no

¹⁹ See, e.g., *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984).

²⁰ Blum & Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. Chi. L. Rev. 651, 664 (1974) (hereinafter "Blum & Kaplan").

²¹ In fact, Congress rejected a proposed amendment by the Bankruptcy Commission to liberalize the absolute priority rule to include continued management or other participation beyond money or money's worth. *Ahlers*, 485 U.S. at 205. At no time during the process of

such policy is reflected in the statute itself, which contains a number of alternatives to reorganization. Thus, Sections 1123(a)(5)(D) and 1141(d)(3) clearly contemplate plans which provide for the sale of all of the debtor's assets; Section 1112(b)(2) authorizes dismissal or conversion of the case if a plan cannot be effectuated; Section 1121(d) permits termination of exclusivity; and Section 1104 gives the court the power to appoint a trustee on discretionary grounds, which could include a debtor's inability to confirm a plan. Several of these provisions offer remedies for the parties' failure to agree; the one remedy conspicuously absent is the bankruptcy court's ability to override class votes on equitable or policy grounds.

Nor did Congress leave a vacuum on this point to be filled by the bankruptcy courts. As argued in Part II above, Congress left the choice between reorganization and liquidation of a chapter 11 debtor to its creditors, even though it certainly knew how to give the bankruptcy court power to override creditor dissent. Congress specifically did so in chapters 12 and 13 of the Code by making creditor consent irrelevant to the confirmability of plans; it did so in establishing the "adequate protection" concept for the use of cash collateral and allowing the bankruptcy court, not the affected creditor, to decide if adequate protection was being provided; and it did so in permitting plans to be confirmed over a secured creditor's rejecting vote based on a showing that the plan would provide the objecting creditor with the value of its interest in the debtor's property or the "indubitable equivalent" thereof. See 11 U.S.C. §§ 361, 363, 1129(b)(2)(A)(iii). Section 1129(b) sets forth different standards for confirming a plan over creditor rejection with respect to secured and unsecured claims, giving the bankruptcy court greater discretion as to secured claims.

While arguments can be offered for giving the court broad equitable powers to confirm plans over creditor opposition and to "balance the interests of debtors, creditors, old owners, and the

enacting the Code did Congress articulate any preference for reorganization as a principle of substantive law which should be enforced by the bankruptcy courts.

public," this view of bankruptcy law simply is not part of the Code. This Court should not, by decision, insert it at this time.

B. The Courts' Difficulty In Applying The New Value Rule Demonstrates Its Infirmities.

In light of the absence of any bankruptcy rationale for the new value rule, courts have found it virtually impossible to apply and have failed to articulate consistent standards for its application. The Court of Appeals summarized the existing standards as follows: existing owners were required to "offer value that was 1) new, 2) substantial, 3) money or money's worth, 4) necessary for a successful reorganization and 5) reasonably equivalent to the value or interest received." 2 F.3d at 908.

Experience in applying these standards exposes numerous structural flaws in the new value rule. Courts applying the "substantiality" requirement have struggled with the question of how much is enough. Some courts have suggested that "substantiality" is not a separate requirement at all, whereas others posit that there must be some proportionality between the new value and the amount of unsecured debt to be discharged.²² Likewise, courts have struggled with various innovative forms of "money's worth" such as guaranties, payment of expenses, forgiveness of existing debt and contributions of property to be used in the reorganized business.²³

The "necessary" component has caused even more interpretive problems. Some courts do not apply this requirement at all.²⁴ Others, such as the Court of Appeals here, have adopted a tautological approach — *i.e.*, if the new value is contributed and

²² Compare *In re Yasperro*, 100 B.R. 91, 97 (Bankr. M.D. Fla. 1989), with *In re Snyder*, 967 F.2d 1126 (CA7 1992).

²³ Compare *In re Potter Material Serv., Inc.* 781 F.2d 99, 103 (CA7 1986) (renewal of shareholders' guaranty held to be new value, even though existing guaranty arguably unaffected by bankruptcy), with *Kham & Nate's Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1362 (CA7 1990) (shareholders' guaranty did not constitute new value). See also *Ahlers*, 485 U.S. at 203 (labor and expertise not new value).

²⁴ See, e.g., *In re Henke*, 90 B.R. 451 (Bankr. D. Mont. 1988).

the negative vote of a dissenting class can be ignored as a result, thus allowing confirmation, the new value is necessary. Still other courts reason that new capital is needed for the continued operation of the business and imply that having cash is always helpful.²⁵ Some courts state that new funds are necessary to pay current obligations under the plan, and others say that if such funds are so used they are not necessary.²⁶ Finally, some courts simply suggest that no sensible outsider would invest the necessary funds.²⁷

Many owners suggest that their contributions are "necessary" to cash out unsecured claims (usually at a few cents on the dollar). This creates a structural problem: the Code does not give owners the power to cash out unsecured claims over their holders' objection and retain the upside. If creditors do not accept a proffered cashout, Section 1129(b) makes them owners. Section 363(k) permits secured creditors to "credit bid," and courts have interpreted this requirement to be applicable to sales under a plan.²⁸ By the same reasoning, unsecured creditors can accept or reject an offer of partial payment. Permitting owners to force creditors to accept a lesser cash return undercuts the essence of

²⁵ *In re Mortgage Inv. Co. of El Paso*, 111 B.R. 604, 620 (Bankr. W.D. Tex. 1990) (must be a showing that capital infusion is necessary for the continued operation of the debtor).

²⁶ Compare *In re Montgomery Court Apartments*, 141 B.R. 324, 345 (Bankr. S.D. Ohio 1992) (contribution necessary to establish a reserve and pay obligations under the plan), with *In re Sovereign Group, 1985-27, Ltd.*, 142 B.R. 702, 708 (E.D. Pa. 1992) (infusion of new capital to pay creditors not necessary to continued operations of debtor).

²⁷ *In re Aztec Co.*, 107 B.R. 585, 588 (Bankr. M.D. Tenn. 1989).

²⁸ See *In re California Hancock, Inc.*, 88 B.R. 226 (Bankr. CA9 1988). Some have proposed, to solve problems with the new value rule, that unsecured creditors be permitted to credit bid in the new value context. See, e.g., Markell at 121-23. However, there are practical problems in trying to conduct an auction when one bidder is a class consisting of many creditors. Such procedure is also likely to be inefficient, costly and time-consuming.

the rule set forth in Section 1129(b), which requires full payment or affirmative class vote. There is no "third choice."

The meaning of the requirement regarding the value of the interest to be retained by existing owners is also uncertain. Some courts require detailed analysis of cash flow and revenues, the value of control, and the value of tax benefits, while other courts permit the test to be satisfied by showing the debtor's history of losses and poor prospects. *See In re U.S. Truck Co.*, 800 F.2d 581, 588 (CA6 1986).

As the courts struggling to apply the new value rule have found, these purported underlying requirements are inherently uncertain, and are only made more so when there is no Congressional policy to serve as a lodestar for the bankruptcy court's analysis.

IV. The New Value Rule Delays Resolution, Distorts Priorities, Increases the Costs of Reorganization, And Makes Credit More Expensive And More Scarce.

Policy concerns militate against recognition of a new value rule: the rule muddies a clear distribution scheme, increases lenders' costs, and taints the lending process.

A. The Code Adopts Specific Distribution Rules Which Allocate Ownership Of Insolvent Entities To Their Creditors.

A reorganization case usually arises from a business, not a legal, problem. The basic issue in a reorganization case is how to allocate "reorganization value" among creditors whose claims have been reduced, restructured or eliminated in accordance with the distribution rules set forth in the Code. Both the process selected for allocating reorganization value and the nature of the rules to be applied within that process are important to creditors because they affect the timing and amount of creditors' recoveries. This is particularly true in the bankruptcy arena, as most

debtors are insolvent,³⁰ which means that the costs of bankruptcy are largely borne by creditors.

The Code adopts a litigation mode, which is often inefficient, for allocating value.³¹ The certainty and precision of the rules to be applied by the courts overseeing the litigation bear on the length of time it will take to resolve issues,³² the cost of resolution and the pressure to compromise. Generally, therefore, creditors' economic interests are served by precise rules that are uniformly applied. Such definitive rules "set guidelines for carrying on negotiations, largely by validating or invalidating certain lines of argument and by fixing boundary marks upon the areas within which negotiation is allowable."³³ When entering into a credit relationship, lenders need such rules in order realistically to evaluate their positions and the risks and rewards of alternative courses of action.

Section 1129(b) is just such a definitive rule: reorganization value is to be distributed hierarchically from senior creditors to junior creditors to owners. Alterations are only allowed if the class adversely affected by the alterations approves. Thus, the Code leaves it to creditors' self-interest to alter priorities; no court has

³⁰ *Amici* have examined each of the reported (Bankruptcy Reporter) post-*Ahlers* cases in the Courts of Appeals and the District Court, as set forth in the Appendix hereto. None involved any question of insolvency.

³¹ Indeed, this inefficiency has led to a spirited debate over whether chapter 11 maximizes creditor recoveries, or whether some form of liquidation, quick sale, or other approach would be preferable. *See generally* LoPucki, *The Trouble With Chapter 11*, 1993 Wis. L. Rev. 729, 730-31 nn. 2-9 (reviewing secondary authorities) (hereinafter "LoPucki"). The choice of a litigation system to resolve bankruptcy is not universal; other countries call upon accountants or public officials to allocate value.

³² Professor LoPucki has found that, on average, smaller cases take more than twice as long to reorganize under the Code than they did under the Act. *See* LoPucki at 745.

³³ Blum & Kaplan at 653.

the power to require classes to so act.³⁴ Another feature of Section 1129(b) is that creditors "own" an insolvent business.³⁵ This ownership includes the right to determine the disposition of both control of the business,³⁶ which is a key element of reorganization value, and the business itself. Applied by its terms, Section 1129(b) functions as a clear, fair distribution rule.

B. Recognition Of A New Value Rule Adversely And Unjustifiably Affects The Lending Process.

1. The Impact Of The New Value Rule.

Even though Section 1129(b) allocates to creditors the value of control over the debtor, the creditors' ability to realize on this value is sharply limited even without a new value rule. The debtor's control over the bankruptcy process, its control over access to information and ability to impose significant costs on others who seek such access, its centralized decisionmaking, its ability to use operating funds for legal and other bankruptcy expenses and to litigate with creditors over distribution issues, its exclusivity period for filing plans and courts' willingness readily to extend that period,³⁷ and its strong economic motives to maintain control and somehow create value for owners, severely affect

³⁴ See *Kham & Nate's*, 908 F.2d at 1360.

³⁵ *Case*, 308 U.S. at 116; *Boyd*, 228 U.S. at 508. Corporate law recognizes that "when a corporation becomes insolvent, the fiduciary duty of directors shifts from the stockholders to the creditors." *FDIC v. Sea Pines Co.*, 692 F.2d 973, 976-77 (CA4 1982), cert. denied, 461 U.S. 928 (1983).

³⁶ Many decisions recognize that control itself can be a corporate asset. See, e.g., *Perlman v. Feldman*, 219 F.2d 173 (CA2 1955).

³⁷ Many courts routinely extend exclusivity periods. In recognition of this problem, Congress recently considered legislation with a one year outside limit. S. 540, 103d Cong., 1st Sess. § 102 (1993). Some judges believe that chaos will ensue if competing plans are filed. See generally *In re Public Serv. Co.*, 88 B.R. 521 (Bankr. D.N.H. 1988) (extending exclusivity, but dismissing debtor's "chaos" argument); LoPucki at 754-56. One study found that in 34 of 43 cases of clearly insolvent debtors, exclusivity continued throughout the case; 27 of the 34 cases lasted for more than two years. LoPucki & Whitford, *Bargaining Over Equity's*

creditors' ability to realize on this element of reorganization value.³⁸

Recognition of a new value rule significantly augments owners' ability to retain control of an insolvent debtor, and thereby further diminishes value accorded to creditors, in complete disregard of the Code's statutory scheme. Thus, application of the new value rule is unsatisfactory because it strips creditors of their Code-granted power to decide how reorganization value will be allocated, giving that power to the bankruptcy court instead;³⁹ the problem is compounded because the "standards" for applying the new value rule substitute judicial discretion and case-by-case analysis for the Code's very specific distribution rules.⁴⁰ The Court of Appeals' approach essentially leaves it to the bankruptcy

Share in the Bankruptcy Reorganization of Large Publicly Held Companies, 139 U. Pa. L. Rev. 125, 128 & n.6 (1990).

³⁸ See LoPucki at 732-39. Indeed, these issues have led commentators to propose various auction procedures or preemptively to exclude insolvent debtors from the confirmation process. See, e.g., Markell at 107-11, 114-16; Note, *The Bankruptcy Code and the New Value Doctrine: An Examination into History, Illusions, and the Need for Competitive Bidding*, 79 U. Va. L. Rev. 917, 948-56 (1993); LoPucki & Whitford, *Preemptive Cram Down*, 65 Am. Bankr. L.J. 625 (1991).

³⁹ *Kham & Nate's*, 908 F.2d at 1360 (the new value exception "means a power in the judge to 'sell' the stock to the managers even when the creditors believe that this transaction will not augment the value of the firm") (emphasis in original).

⁴⁰ See *In re Greystone III Joint Venture*, 995 F.2d 1274, 1284 (CA5 1991) (Jones, J. dissenting, observing that if courts "may implement 'new value' nonconsensual reorganizational plans governed by such amorphous standards, one wonders why Congress bothered to frame elaborate ground rules for achieving consensual plans."), corrected, reinstated, reh'g denied, 995 F.2d 1284 (CA5 1991), cert. denied, 113 S. Ct. 72 (1992). One effect of the Court of Appeals' decision below may be to immunize new value determinations from effective appellate scrutiny because of the difficulties in reviewing decisions balancing multiple factors which tend to be highly discretionary and subjective, and the failure to tie the factors to any verifiable bankruptcy policy.

court to work out the details, thereby encouraging fencing, bluffing, posturing, and all the attendant problems of litigation — all to resolve a basic issue which Congress already has decided. Ultimately, the procedure contemplated by the Court of Appeals would increase costs and delay resolution.

The problem is exacerbated in many cases where owners attempting to use the new value rule propose plans containing other mechanisms which undermine creditors' rights, such as classifying claims in such a way as to guarantee the necessary accepting class required by Section 1129(a)(10).⁴¹ These various devices have often resulted in insolvent debtors proposing plans which are opposed by the creditors who have the overwhelming economic interest in the debtor, and which negate the protections accorded by Congress in Section 1129(b).

For creditors, the introduction of a new value rule lowers predictability, increases costs, and ultimately forces concessions to owners. Thus, the creditor confronted with a debtor's proposed new value plan must either oppose the plan and/or try to confirm a competing plan (which the owners will oppose). There is little downside or cost to the owners, since they are already "out of the money." By contrast, the creditor must fund not only the costs of its own litigation, but since the debtor is insolvent, the owners' costs in seeking to confirm their plan.⁴² Bankruptcy expenses continue while the litigation goes on, and the creditor faces the real risk of an erosion of the value of the business and a concomitant decline in reorganization values.⁴³

Given the vagaries of the new value rule, no lawyer can assure a creditor client of certain, or even probable, victory in the litiga-

⁴¹ *Greystone*, 995 F.2d at 1277; *In re Bryson Properties XVIII*, 961 F.2d 496, 501 (CA4), cert denied, 113 S. Ct. 191 (1992).

⁴² The owners' costs are usually included in the debtor's legal fees; owners rarely retain and compensate their own counsel.

⁴³ Business rarely improves in bankruptcy, once some initial stabilization takes place. Moreover, owners and managers of insolvent enterprises have "powerful economic incentives . . . toward reckless, high risk, short term investment policies." LoPucki at 732.

tion. Even defeating the new value plan may be a Pyrrhic victory, in that reorganization value will have declined and the plan process must begin anew. Under these circumstances, even the hardest creditor is inclined to eschew the fight and give up some value to owners.⁴⁴ This is, of course, precisely what is *not* supposed to happen under Section 1129(b) and the decisions of this Court applying the "fair and equitable" doctrine.

2. The Stated Rationales For The New Value Rule Are Specious.

None of the policies articulated by proponents of the new value rule overrides Congress' decision to structure reorganizations around creditor choice and to specify a distribution scheme for the creditors of insolvent debtors.

a. *Auction.* New value plans have been analogized to "auctions," at which the owners wind up as the high bidders.⁴⁵ In fact, a new value plan is the antithesis of an auction because neither creditors nor outsiders are permitted to bid.⁴⁶ Moreover, no reason has ever been offered for permitting the court to require an auction when the creditors do not choose to have one. The essence of Congress' choice to permit classes to vote against a plan, and to define what a rejecting class must receive for the plan to be confirmed notwithstanding such rejection, is the determination both to define the choice facing creditors and leave the choice up to creditors.⁴⁷

b. *Reorganization.* A second attempted justification for a new value rule is that the debtor needs the owners' contribution to

⁴⁴ Skeel, *The Uncertain State of an Unstated Rule: Bankruptcy's Contribution Rule After Ahlers*, 63 Am. Bankr. L. J. 221, 246-47 (1989).

⁴⁵ E.g., Markell at 107-111.

⁴⁶ The Court of Appeals implied that the opportunity to provide new value need not be extended to creditors or third parties. 2 F.3d at 910-11.

⁴⁷ *Kham & Nate's*, 908 F.2d at 1360; *Greystone*, 995 F.2d at 1284. The bankruptcy court can always disallow votes cast in bad faith. See 11 U.S.C. §1126(e).

reorganize. This rationale fails as well: contrary to the Court of Appeals' opinion below, there is no reason to prefer a specific form of reorganization which permits owners to contribute funds and retain their ownership interests, or even to reorganize at all. If reorganization is the best economic alternative and new funds are required for continuing operations or capital expenditures, it should be possible to convince creditors to vote for a plan which either provides new value from owners in exchange for stock, or contemplates that creditors will put up the contributions themselves, or proposes a mechanism to raise the funds from a third party.

Presuming that reorganization using owners' funds is a preferred result, and that creditors opposing this result are merely being obstructionist, obscures the fact that disputes over new value are usually disputes over business issues such as the need for new money, the amount needed, the ability to obtain funds in other ways, the amount of equity a new contribution should buy, or even the wisdom of reorganization itself. The Code does not give bankruptcy courts the power to resolve such business issues in favor of reorganization, but has left them to resolution through negotiations over distribution of reorganization value under the plan. In the context of those negotiations, the Code gives creditors the choice between the best deal they can negotiate and the treatment they are entitled to under Section 1129(b). If negotiations fail, the court has no roving power to impose a solution on creditors or to require reorganization.

c. Access to Capital Markets. Yet another purported justification for recognition of a new value rule is that it enhances reorganizing debtors' access to the capital markets.⁴⁸ Yet as noted, most cases in which courts actually have applied the new value rule involve "single asset" real estate, farms or small, closely-held corporations. Although "access to the capital mar-

⁴⁸See generally Warren, *A Theory of Absolute Priority*, 1991 Survey of American Law 9, 14-16 (1991).

kets" has an appealing ring, it has little relevance to these cases, which do not involve attempts to sell a complex enterprise.⁴⁹

d. Creditor Plans. Finally, it has been argued that there is no harm in allowing debtors to take advantage of a new value rule, as creditors who disagree on the optimal shape of the reorganization can propose their own plan. Indeed, many commentators, and the influential National Bankruptcy Conference, believe that some assurance that creditors facing new value plans will be able to file their own plans is the solution to problems with the new value rule.⁵⁰

This proposal has a number of flaws. First, creditors' ability to file their own plans is not a substitute for the certainty to which they are entitled under Section 1129(b). Second, proposing a competing plan merely exacerbates the litigation issues discussed earlier. Third, if both the creditor's plan and the debtor's plan are accepted, the bankruptcy court will have to choose one to confirm, and Section 1129(c), which governs the court's choice and requires the court to take into account creditors' and equity security holders' preferences, offers no guidance as to which plan should be approved in this situation.

Finally, preparing a creditor's plan is difficult for even the largest and best-financed creditors, given the lack of access to information and other practical and financial disincentives. Filing a creditor's plan is significantly more expensive than opposing a plan proposed by the debtor which does not comply with Section 1129(b), and there are many creditors who actively participate in cases and negotiate over plan treatment who cannot devote sufficient resources to prepare, file, and litigate creditor plans. Moreover, it is not an "either-or" proposition: a creditor proposing its own plan must still oppose the debtor's plan.

⁴⁹ Single asset real estate debtors usually have little or no going concern value.

⁵⁰ See ALI-ABA Conference, *Bankruptcy Reform Circa 1993, A Presentation of the National Bankruptcy Conference's Bankruptcy Code Review Project* 253-55 (1993); Note, *supra* note 38, at 947-51 & n.193 (citing authorities).

3. Summary.

The Court of Appeals' decision defies certainty and promotes litigation. Application of a new value rule delays resolution, allows owners which are often "out of the money" to prolong the process, and deprives creditors of their statutory choice between the best deal they can make with the debtor and their minimum entitlement under Section 1129(b), compelling them instead to choose between the costs of delay and the uncertainties of litigation, on the one hand, and the cost of buying peace, on the other hand. These practical concerns frequently compel settlements that result in a transfer of reorganization value to owners, and increase the overall cost of credit — an increase which must be passed on to all borrowers.

V. The Plain Meaning Principle Precludes Recognition Of A New Value Rule.

Adoption of the new value rule is precluded by the "plain meaning" principle, as articulated in this Court's recent decisions holding that pre-Code practice and legislative history are of only marginal relevance in interpreting the Code. In *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-242 (1989), this Court held that in the context of a comprehensive statutory scheme that comprises a substantial overhaul of prior law, the plain meaning of the statute should control unless a clearly unintended result would ensue. Although this Court has rendered a number of subsequent bankruptcy decisions, each — properly interpreted — reflects the standard set forth in *Ron Pair*.⁵¹

⁵¹ See, e.g., *Patterson v. Shumate*, 112 S. Ct. 2242, 2247 (1992) ("plainly read, [Section 541(c)(2)] encompasses any relevant nonbankruptcy law, including federal law such as ERISA"); *Dewsnup v. Timm*, 112 S. Ct. 773 (1992) (pre-Code practice relevant only where provision at issue ambiguous); *Union Bank v. Wolas*, 112 S. Ct. 527, 531 (1991) ("[T]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning"); *Toibb v. Radloff*, 111 S. Ct. 2197, 2200 (1991) (legislative history is irrelevant unless the statute is unclear); *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S.

A. Language Of Section 1129(b)(2).

Under Section 1129(b), a plan can be confirmed over a class' rejecting vote if various requirements are satisfied. A basic principle of Section 1129(b) is that the plan must be "fair and equitable" with respect to each dissenting impaired class. For a class of unsecured creditors, Section 1129(b)(2) requires the court to find that either they will be paid in full or that no junior claimant will receive any value under the plan "on account of" its claim, and does not provide any power to vary its provisions on equitable grounds or to recognize additional bases for cramdown. By contrast, other sections of the Code, such as Sections 361 and 552(b), specifically include equitable or value-based provisos and exceptions.

B. The Court Of Appeals Misread The "On Account Of" And "Includes" Language Of Section 1129.

The Court of Appeals below held that the plain language of Section 1129(b)(2)(B)(ii) — and in particular, the proviso "on account of" — was not inconsistent with recognition of a new value rule. The court reasoned that in a new value plan, owners are not receiving property under the plan "on account of" their prior ownership interests, but are receiving such property on account of their contribution of "new value." 2 F.3d at 908-11. This argument is flawed. Even the Court of Appeals recognized that "in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners." 2 F.3d at 909. In fact, what owners seek is the exclusive right to propose a new value plan, and the exclusive right to have such a plan confirmed over the objections of creditors. These exclusive rights are value received "on account of" the prior ownership interests, as is the ownership interest received under a new value plan.

The Court of Appeals attempted to avoid the conclusion that a new value plan inevitably gives owners an interest in property "on account of" their equity interests by constructing a distinction

552, 563 (1990) (Court refused to resort to pre-Code practice where Congressional intent was clear from terms of statute).

between “direct or immediate causation” and “a more remote variety.” 2 F.3d at 909. This distinction is completely unsupported by any of the statutory language or legislative history.⁵²

The Court of Appeals also relied on the word “includes” in the prefatory language in subsection 1129(b)(2) as leaving room for judicial “legislation” of the new value rule. 2 F.3d at 912. This reasoning is directly contradicted by the *Ahlers* case, where this Court stated that “a reorganization plan in which [debtors] retain an equity interest in the farm is contrary to the absolute priority rule.” 485 U.S. at 202. Although Section 102(3) provides that the word “includes” is not limiting, it should not be read to permit an exception directly contrary to a statutory rule.

C. The Court Of Appeals Misinterpreted *Dewsnup* And *Davenport* To Create A Rule Overly Deferential To Pre-Code Practice.

The Court of Appeals announced the following rule of statutory construction: “Once it has been shown that Congress was aware of a pre-Code practice, the remaining inquiry under *Dewsnup* and *Davenport* is whether it has made clear its intent to change that practice.” 2 F.3d at 912. This “rule” is contrary to *Ron Pair* and its progeny, contrary to settled principles of statutory construction, and even contrary to the *Dewsnup* and *Davenport* decisions themselves, properly interpreted.

In *Dewsnup*, this Court used pre-Code practice as a guide to Congressional intent given manifest ambiguity in Section 506(d),

⁵² In misinterpreting the “on account of” language, the Court of Appeals also misapplied the traditional principle of statutory construction that “a Court must give effect, if possible, to every clause and word of a statute,” 2 F.3d at 908, and suggested that the “on account of” language would be “superfluous” if there were no new value rule. 2 F.3d at 909. This statement overlooks an obvious meaning for the “on account of such junior claim or interest” phrase. Without the phrase, an entity which happened to hold both a senior claim and a junior claim (or interest) would be barred from receiving any property under the plan, even though other holders of senior claims would receive property under the plan. The “on account of” language simply avoids the absurd result of penalizing the holder of a senior claim for also holding a junior claim.

which seems to permit a debtor to “strip down” liens to the value of the underlying property. This Court noted that such an interpretation directly contradicts the legislative history of Section 506(d), which states that such section permits liens to pass through the bankruptcy case unaffected. 112 S. Ct. at 779. Such an interpretation also contradicts the general structure of the Code for numerous reasons: (1) it operates as an avoiding power, although all other avoiding powers are specified in Subchapter III of the Code, (2) it overlaps and somewhat overrides carefully balanced provisions in Section 522, and chapters 11, 12, and 13 dealing with the treatment of undersecured claims (*i.e.*, claims exceeding the value of collateral), and (3) it conflicts with the redemption provision of Section 722. Unlike in *Dewsnup*, here there is no legislative history or statutory framework supporting the new value rule which is inconsistent with the provisions of Section 1129(b).

The Court of Appeals cited *Davenport* for the proposition that “[t]he Bankruptcy Code should not be read to abandon past bankruptcy practice absent a clear indication that Congress intended to do so.” 2 F.3d at 912. In relying on this one passage taken out of context, however, the court ignored the holding in *Davenport*. In *Davenport*, this Court held that criminal restitution obligations are dischargeable debts under chapter 13, because they constitute “debts” under the plain language of Section 101(11). This Court refused to resort to pre-Code practice, concluding that Congressional intent was clear. This principle applies equally to the construction of Section 1129(b).

D. The Legislative History Shows That Congress Rejected The New Value Rule.

Even if Section 1129(b)(2)(B)(ii) is held to be “ambiguous,” the legislative history shows that Congress did not intend to enact the new value rule into law. Congress explicitly adopted the absolute priority rule, and the legislative history of the statute supports an unqualified absolute priority rule.⁵³ Moreover, Con-

⁵³ House Report at 413 (“The general principle of the subsection permits confirmation notwithstanding non-acceptance by an impaired class if that class and all below it in priority are treated according to the

gress clearly was familiar with Chapter XI of the Act, which contained no absolute priority rule, and did not enact any such requirement in chapters 12 or 13.

Further, the Commission Report contained an express and detailed proposal for codifying the new value exception. Commission Report at 242. The court below, in a counterintuitive use of legislative history, used Congress' rejection of the proposal to support the new value rule. 2 F.3d at 912. The more natural interpretation of Congress' rejection of the proposal is that Congress rejected the new value rule.⁵⁴

CONCLUSION

For the reasons stated herein, this Court should hold that Section 1129(b) does not embrace or incorporate a new value rule, and that a new value rule is inapplicable in chapter 11 cases under the Code.

Respectfully submitted,

Of Counsel:

CHRISTOPHER E. CHENOWETH
CALIFORNIA BANKERS ASS'N
455 Market Street, 17th Floor
San Francisco, CA 94105

MICHAEL F. CROTTY
AMERICAN BANKERS ASS'N
1120 Connecticut Avenue, NW
Washington, DC 20036

JONATHAN M. LANDERS*
KATHRYN A. COLEMAN
GREGORY J. CONKLIN
LINDA L. CURTIS
DESMOND J. CUSSEN
GIBSON, DUNN & CRUTCHER
1 Montgomery Street
San Francisco, CA 94104
(415) 393-8200
Attorneys for Amici Curiae
**Counsel of record*

absolute priority rule. The dissenting class must be paid in full before any junior class may share under the plan.”)

⁵⁴ The Commission's proposal was itself the subject of scholarly debate and was criticized as inconsistent with the absolute priority rule, thus weakening the “adoption by silence” argument. See, e.g., Blum & Kaplan at 667-72.

THE APPENDIX INCLUDED HEREIN HAS BEEN REPRODUCED
AND SEPARATELY LODGED WITH THE CLERK OF THIS COURT

APPENDIX
Court of Appeals Cases Dealing with New Value Rule since *Ahlers*

<u>Case</u>	<u>Type of Business</u>	<u>Alleged New Value</u>	<u>Court's Holding</u>	<u>Dispute over Debtor's Insolvency</u>
<i>Seattle Mortgage v. Bond</i> , 193 U.S. App. LEXIS 34459 (CA9 1993)	Individual farm	Promise of future payments	Promise did not constitute new value	No
<i>In re Bonner Mall Partnership</i> , 2 F.3d 899 (CA9 1993), cert. granted, 126 L. Ed. 2d 648 (1994)	Real estate limited partnership (single asset)	\$200,000 cash and certain guarantees	New value rule survives. No decision on whether rule was satisfied	No
<i>Urnuth v. Rushville State Bank of Rushville, Missouri</i> , 987 F.2d 1506 (CA10 1993)	Farm which was operated as a sole proprietorship	Exempt property, postpetition wages from independent employment, labor	Proposed contribution did not constitute new value	No
<i>In re Snyder</i> , 967 F.2d 1126 (CA7 1992)	Farm	\$30,000 cash and release of lien on machinery	\$30,000 was not substantial enough and a release of lien did not constitute new value	No
<i>In re Bryson Properties</i> , XVIII, 961 F.2d 496 (CA4 1992), cert. denied, 113 S.Ct. 191 (1992)	Real estate limited partnership (single asset)	Cash contribution of \$625,000 which was to be used for asbestos clean-up and the continued operation of the partnership and a line of credit of \$850,000, each of which was to be repaid from the proceeds of a sale of the real estate asset after payment of the secured claim	Even if there was some limited exception to the absolute priority rule, it was not satisfied here	No

<u>Case</u>	<u>Type of Business</u>	<u>Alleged New Value</u>	<u>Court's Holding</u>	<u>Dispute over Debtor's Insolvency</u>
<i>In re Greystone III Joint Venture</i> , 995 F.2d 1274 (CA5 1991), corrected, reinstated, <i>reh'g denied</i> , 995 F.2d 1284 (CA5 1991), cert. denied, 113 S. Ct. 72, (1992)	Real estate joint venture single asset)	\$500,000 cash	Court's holding that there is no new value rule was withdrawn. Case decided on improper classification grounds	No
<i>In re Anderson</i> , 913 F.2d 530 (CA8 1990)	Farm	Unspecified amount of cash from unidentified relatives Loan guaranty of \$435,000	This did not constitute new value Guaranty did not constitute new value	No
<i>Kham & Nae's Shoes No. 2, Inc., v. First Bank of Whiting</i> , 908 F.2d 1351 (CA7 1990), <i>reh'g denied, en banc</i> , 1990 U.S. App. LEXIS 18381 (CA7 1990)	Small Business (closely held)	Labor	Labor did not constitute new value	No
<i>In re Stegall</i> , 865 F.2d 140 (CA7 1989)	Farm			

District Court Cases Dealing with New Value Rule since Ahlers

<u>Case</u>	<u>Type of Business</u>	<u>Alleged New Value</u>	<u>Court's Holding</u>	<u>Dispute over Debtor's Insolvency</u>
<i>In re F.A.B. Industries</i> , 147 B.R. 763 (C.D. Cal. 1992)	Real estate general partnership (single asset)	\$2,000,000 cash. Unclear how cash was to be used.	There is a new value rule. No decision on whether rule was satisfied	No
<i>In re Triple R Holdings</i> , 145 B.R. 57 (N.D. Cal. 1991)	Real estate general partnership (single asset)	Cash payments from debtor (amount unspecified)	No new value rule	No
<i>In re Sovereign Group</i> , 1985-27, Ltd., 142 B.R. 374 (E.D. Pa. 1992)	Real estate limited partnership (single asset)	\$135,000 in cash and a cashflow guaranty valued at \$65,000	Guaranty does not constitute new value. \$135,000 is not substantial enough	No
<i>In re Tara Limited Partnership I</i> , 1991 U.S. Dist. LEXIS 20144 (W.D. Wis. 1991)	Real estate (single asset)	Option of partners to contribute up to \$100,000 each	Receipt of option without payment of value violated new value rule	No
<i>Piedmont Associates v. Cigna Property Casualty Insurance Company</i> , 132 B.R. 75 (N.D. Ga. 1991)	Real estate joint venture (single asset)	New partner to provide \$841,000 for an 80% interest, existing partner to get a loan from new partner to acquire remaining 20%	Scheme amounted to sale of property which exceeded scope of new value rule	No
<i>In re Lumber Exchange Limited Partnership</i> , 143 B.R. 354 (D. Minn. 1991); <i>aff'd on other grounds</i> , 468 F.2d (CA8 1992)	Real estate limited partnership (single asset)	\$800,000 (\$200,000 to be paid to unsecured creditors and \$600,000 to be used for changes and improvements)	Case dismissed as confirmation would result in confirmation of a plan for the benefit of 3% of claims and speculative interest of owners	No

Addendum 1

The New York State Bankers Association (“NYSBA”) is the principal trade association for the commercial banking industry in New York State. Its 150 domestic and non-resident member banks collectively hold nearly \$700 billion in assets and employ 170,000 persons in the State. The NYSBA’s members, most of which are actively engaged in the business of making both secured and unsecured loans, include some of the largest banking organizations in the United States.

From time to time as appropriate the NYSBA appears as *amicus curiae* in cases that raise significant questions of law affecting the commercial banking industry and which have a direct, substantial and continuing impact on its members. This is such a case. This Court’s determination of the issues presented in this appeal unquestionably will have a profound effect on the conduct of secured lending business by NYSBA member banks, both in New York State and elsewhere throughout the United States.

(14)

In The
Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,

Petitioner,

v.

BONNER MALL PARTNERSHIP,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

**MOTION FOR LEAVE TO FILE A BRIEF AS AMICUS
CURIAE AND BRIEF OF THE AMERICAN COLLEGE OF
REAL ESTATE LAWYERS AS AMICUS CURIAE
IN SUPPORT OF PETITIONER**

Of Counsel:

PAUL A. ROBERTS
President, American College
of Real Estate Lawyers

THOMAS C. HOMBURGER
Co-Chair, Amicus Briefs
Committee, American College
of Real Estate Lawyers

PROF. WALTER J. TAGGART
Chair, Bankruptcy
Committee, American College
of Real Estate Lawyers

MICHAEL S. KHOURY
DAVID FOSTER
CLARK, KLEIN & BEAUMONT

EUGENE YAMAMOTO
LANDELS, RIPLEY & DIAMOND

CHRISTINA L. FEEGE
THACHER, PROFFITT & WOOD

Counsel of Record:

PROF. ROBERT M. ZINMAN
St. John's University
School of Law
8000 Utopia Parkway
Jamaica, New York 11439
(718) 990-6646
Co-Chair, Amicus Briefs
Committee, American College
of Real Estate Lawyers

CHRISTOPHER F. GRAHAM
THACHER, PROFFITT & WOOD
2 World Trade Center
New York, New York 11048
(212) 912-7400

No. 93-714

In The

Supreme Court of the United States

October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,

Petitioner,

v.

BONNER MALL PARTNERSHIP,

Respondent.

**On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit**

**MOTION FOR LEAVE TO FILE A
BRIEF AS AMICUS CURIAE**

The American College of Real Estate Lawyers ("ACREL") by and through their undersigned attorney hereby respectfully moves this Court for leave to file the attached *amicus curiae* brief in support of U.S. Bancorp Company (the "Petitioner") in the above captioned matter (the "Appeal") and respectfully represent as follows:

Consent of Parties

The consent of the attorney for the Petitioner has been obtained. A letter evidencing such consent is attached hereto as exhibit A. The consent of the attorney for the Respondent was requested but refused.

Interest of the Amicus Curiae

I. ACREL is a non-profit corporation organized for the purpose of gathering together lawyers to improve and reform real estate law. ACREL's membership consists of approximately 800 attorneys from nearly every state and the District of Columbia who have concentrated their practice in real estate law for a period of ten years or more, and law professors specializing in the field of real estate law. The case at bar involves a single asset debtor owning commercial real estate.

II. ACREL believes that the decision of the Ninth Circuit, if upheld, will have serious adverse affects upon the availability of financing for the acquisition and development of commercial real property in the United States.

III. ACREL therefore has an interest in presenting to the Court the view that in the broad context of public policy and future economic development, the interpretation of the Bankruptcy Code advanced by the Ninth Circuit is erroneous and should be overruled.

The Proposed Amicus Curiae Brief

IV. A copy of the proposed *amicus curiae* brief is submitted herewith. The proposed brief focuses on legal and policy arguments not made in the brief of the Petitioner.

Conclusion

Due to the *Amicus'* substantial interest in the outcome of the Appeal and due to the importance of the issues presented, the *Amicus* hereby requests that their

motion for leave to file an *amicus curiae* brief in the Appeal be granted.

Dated: New York, New York
February 22, 1994

Respectfully submitted,

CHRISTOPHER F. GRAHAM
THACHER PROFFITT & WOOD
Two World Trade Center
New York, New York 10048
(212) 912-7400

PROFESSOR ROBERT M. ZINMAN
St. John's University
School of Law
8000 Utopia Parkway
Jamaica, New York 11439
(718) 990-6646

*Attorneys for American
Counsel of Real Estate
Lawyers*

No. 93-714

In The
Supreme Court of the United States
October Term, 1993

U.S. BANCORP MORTGAGE COMPANY,
Petitioner,
v.

BONNER MALL PARTNERSHIP,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

**BRIEF OF THE AMERICAN COLLEGE
OF REAL ESTATE LAWYERS AS AMICUS CURIAE
IN SUPPORT OF PETITIONERS**

QUESTION PRESENTED

1. Whether the "new value exception" to the "absolute priority rule" survived the codification of a modified absolute priority rule under §1129(b)(2)(B)(ii) of the Bankruptcy Code, which does not reflect such exception?
2. Assuming, *arguendo*, the existence of a "new value exception" did the Ninth Circuit properly apply such exception?⁵

TABLE OF CONTENTS

	Page
QUESTION PRESENTED.....	i
TABLE OF AUTHORITIES.....	iv
STATEMENT OF INTEREST OF AMICUS CURIAE ...	1
SUMMARY OF ARGUMENT.....	2
ARGUMENT	
I. "NEW VALUE EXCEPTION" DOES NOT SURVIVE THE ENACTMENT OF THE BANKRUPTCY CODE.....	3
A. Relevant Statutes	3
B. Origin of the "New Value Exception" Under Prior Law.....	7
C. Congress Revises the Absolute Priority Rule.....	9
II. THE ADOPTION OF THE "NEW VALUE EXCEPTION" BY THE NINTH CIRCUIT AND ITS APPLICATION TO SINGLE ASSET REAL ESTATE REORGANIZATIONS IS A DISTORTION OF THE "NEW VALUE EXCEPTION" AND ABROGATES THE ABSOLUTE PRIORITY REQUIREMENTS OF THE BANKRUPTCY CODE.....	11
III. THE NINTH CIRCUIT'S APPLICATION OF THE "NEW VALUE EXCEPTION" IS CONTRARY TO THE EXPRESS PROVISIONS OF §1129(B)(2) OF THE BANKRUPTCY CODE...	15

TABLE OF CONTENTS – Continued

	Page
A. Under the "New Value Exception" as Articulated by the Ninth Circuit, The Holder of the Secured Claim Will Not Receive the Allowed Amount of its Claim as Required by §1129(b)(2)(A)(i) of the Bankruptcy Code.....	15
B. Under the "New Value Exception" as Reformulated by the Ninth Circuit, the Debtor Will Retain an Interest Without Providing the Unsecured Creditors with Property of a Value Equal to the Allowed Amount of their Claims Contrary to the Express Language of §1129(b)(2)(B)	16
IV. THE APPLICATION OF THE "NEW VALUE EXCEPTION" TO SINGLE ASSET REAL ESTATE REORGANIZATIONS SERVES NO PUBLIC PURPOSE AND ABROGATES THE PROTECTION FOR THE MORTGAGEE BUILT INTO THE BANKRUPTCY CODE...	18
A. No Public Purpose	18
B. Abrogation of Mortgagee Protection....	19
1. Absolute Priority.....	19
2. Treatment of Absolute Priority Under the Bankruptcy Code	22
V. IF THE NINTH CIRCUIT'S DECISION IS ALLOWED TO STAND, IT WOULD HAVE A SEVERE AND NEGATIVE IMPACT ON BORROWERS, LENDERS AND THE REAL ESTATE INDUSTRY.....	24
CONCLUSION	25

TABLE OF AUTHORITIES

Page

CASES

<i>Case v. Los Angeles Lumber Product Co.</i> , 308 U.S. 106 (1939)	<i>passim</i>
<i>Caminetti v. United States</i> , 242 U.S. 855 (1917)	6
<i>Dewsnup v. Timm</i> , 112 S. Ct. 773 (1992).....	10, 11
<i>In re KRO Associate</i> , 4 Bankr. Ct. Dec. (CCH) 462 (Bankr. S.D.N.Y. 1978)	22
<i>Northern Pacific Railway Co. v. Boyd</i> , 228 U.S 482 (1913)	13, 20
<i>Norwest Bank Worthington v. Ahlers</i> , 485 U.S. 197 (1989)	11, 14, 24
<i>In re Outlook/Century Ltd.</i> , 127 B.R. 650 (Bankr. N.D. Cal. 1991).....	14, 20
<i>In re Pine Gate Associates, Ltd.</i> , 2 Bankr. Ct. Dec. (CCH) 1478 (Bankr. N.D.Ga. 1976)	21, 22, 24
<i>United States v. Ron Pair Enterprises, Inc.</i> , 489 U.S. 235 (1989).....	6

STATUTES

11 U.S.C. §506(a)	<i>passim</i>
11 U.S.C. §1124.....	4
11 U.S.C. §1126(c)	4
11 U.S.C. §1129.....	<i>passim</i>

TABLE OF AUTHORITIES - Continued

Page

MISCELLANEOUS

<i>Broude, Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative</i> , 39 BUS. LAW 441 (1984)	21, 22
<i>Brudney, The Bankruptcy Commission's Proposed "Modification" of the Absolute Priority Rule</i> , 48 Am. Bankr. L.J. 305, 337 (1974)	10
5 Collier on Bankruptcy (L. King 15th Ed. 1986)	21
Collier Real Estate Transactions and the Bankruptcy Code (L. Cherkis 1985)	21
<i>Note, The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule of Corporate Reorganizations</i> , 87 Harv. L. Rev. 1786, 1817 (1974).....	10
Report of the Commission on the Bankruptcy Laws of the United States (H.R. Doc. No. 137, Parts I and II, Cong., 1st Sess. (1973))	9
S. Rep. No. 989, 95th Cong. 2d Sess. 65, reprinted in 1978 U.S. Code Cong. Admin. News 5851.....	22
Salvatore G. Gangemi and Stephen Bordanaro, <i>New Value Exception: Square Peg in a Round Hole</i> , 1 Am. Bankr. Inst. L. Rev. 173, 194 and n.130 (1993)	12

STATEMENT OF INTEREST OF AMICUS CURIAE

The American College of Real Estate Lawyers ("ACREL") is a nonprofit corporation, organized for the purpose of, *inter alia*, gathering together lawyers "to improve and reform real estate law and practice." (ACREL Articles of Incorporation at 2). ACREL's membership consists of over 800 attorneys from nearly every state and the District of Columbia who have concentrated their practice in real estate law for a period of ten years or more and law school professors specializing in the field of real estate law. In addition, members elected to ACREL must have demonstrated a willingness to devote time to improving real property law through writing, teaching or participation in professional association activities. ACREL's membership represents the entire spectrum of the real estate industry including borrowers, lenders, investors and developers. The case at bar – like almost all cases under the 1978 Bankruptcy Code involving the applicability of a "new value exception" to the present Bankruptcy Code's requirements for confirmation of a plan notwithstanding creditor rejection – involves a single asset debtor owning commercial real estate that has declined in value to a point where the debtor's real estate is worth less than the amount of secured debt on the property. ACREL is therefore in a position to offer an unbiased and knowledgeable opinion as to the proper resolution of the issues now before this Court.

This brief supports the position of the Petitioner in this case. Due to the background of the Amicus and its experience as counsel to lenders and borrowers, it is in a unique position to offer its expertise to this Court concerning the adverse effects caused by an affirmation of the

decision below on the availability of financing for the acquisition and development of commercial real property in the United States.

SUMMARY OF ARGUMENT

The Court of Appeals' decision in *In re Bonner Mail* upholding the application of the "new value exception" to the absolute priority rule is contrary to the express language of §1129(b)(2)(B) of the Bankruptcy Code and the intention of Congress. Nothing in the express language of the Bankruptcy Code supports the Ninth Circuit's conclusion that the "new value exception" survived enactment of the Bankruptcy Code in 1978 and, in fact, the plain language of §1129(b)(2)(B) controverts such a conclusion.

Even assuming, *arguendo*, that the "new value exception" is still viable, the Ninth Circuit's decision nevertheless should be reversed, as the Ninth Circuit's application of the exception is a distortion of the traditional "new value exception" for operating businesses created by this Court in *Case v. Los Angeles Lumber*. This distortion arises from the application of the "new value exception" to a single asset real estate plan, which would allow the debtor and its principals to keep the assets of the enterprise without compensating unsecured creditors, thus abrogating the absolute priority requirements of the Bankruptcy Code. In addition, the Ninth Circuit's articulation of the "new value exception" violates the express

provisions of §1129(b)(2) of the Bankruptcy Code by preventing both secured and unsecured creditors from receiving the allowed amount of their claims.

As a final matter, the public policy rationale for the application of the "new value exception", which is based on the desire to maintain the going concern's value of the debtor's business and to keep people employed, is inapplicable in the single asset real estate context because the commercial real estate involved will continue in operation – only the ownership will change. Thus, there is no public policy rationale to uphold the application of the "new value exception" in the instant case.

ARGUMENT

I. "New Value Exception" Does Not Survive the Enactment of the Bankruptcy Code.

A. Relevant Statutes.

Nothing in the language of the Bankruptcy Code supports the Ninth Circuit's conclusion that the new value "exception" survived the enactment of the Bankruptcy Code. The Bankruptcy Code contains extensive provisions governing confirmation of plans of reorganization by the Bankruptcy Courts. 11 U.S.C. §1129.

Section 1129(b) of the Bankruptcy Code* details the limited circumstances under which a Bankruptcy Court may confirm – or "cramdown" – a plan even if a class of

* 11 U.S.C. §101 et seq. All section references are to the Bankruptcy Code.

creditors has not voted to accept the plan in accordance with §1129(a)(8).¹ Under this section, such a plan may be confirmed despite the non-acceptance of a creditor class "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. §1129(b)(1). Unlike the prior Bankruptcy Act, §1129(b) proceeds to define "fair and equitable" with respect to particular classes that have not accepted the plan. Congress chose not to include any "new value exception" in such definition. Section 1129(b)(2)(B) requires that for a plan to be "fair and equitable" with respect to a non-accepting class of unsecured claims

¹ Pursuant to §1129(a)(8) of the Bankruptcy Code, each class of claims or interests must either vote to "accept" the plan or not be "impaired" under the plan. See generally 11 U.S.C. §1124. Very few bankruptcy cases involve a situation where a class of unsecured creditors is not impaired under a plan. Pursuant to §1126 of the Bankruptcy Code, a class of creditors is deemed to have accepted a plan if such plan has been accepted by creditors that hold at least two thirds in amount and more than one half in number of the allowed claims of such class held by creditors that have voted to accept or reject the plan. 11 U.S.C. §1126(c). In short, individual dissenting creditors in a class can be outvoted by similarly situated creditors thus making possible confirmation of a plan that has been accepted by the requisite majorities. Significantly, the Bankruptcy Act of 1898, as amended by the Chandler Act of 1938, under which *Case v. Los Angeles Lumber* was decided, did not permit creditor majorities to accept a plan over the dissent of a single creditor in a class. (See discussion below).

(including a class containing a secured creditor's deficiency claim)² the plan must either (i) provide for full

² Pursuant to §1111(b)(1)(A), a deficiency claim of a non-recourse lender is treated as a *recourse* unsecured claim against a debtor. The subsection provides in pertinent part:

A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this Title, the same as if the holder of such claim had recourse against the debtor on account of such claim whether or not such holder has such recourse, unless

- (i) the class of which such claim is a part elects, by at least two thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or
- (ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

Indicative of Congressional intent is that fact that neither exception to this rule permits a debtor to maintain the property in question *and* pay the secured creditor less than the full amount of its claim.

Section 506(a) of the Bankruptcy Code provides that any such deficiency claim "is an unsecured claim". The section provides in pertinent part:

"An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set-off under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to set-off, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set-off is less than the amount of such allowed claim." 11 U.S.C. §506(a).

Consequently, a deficiency claim of an undersecured creditor is accorded the treatment of an unsecured claim and is normally classified together with other unsecured claims.

payment on such claim or (ii) the holder of any claim or interest junior in priority to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property. 11 U.S.C. §1129(b)(2)(B) (emphasis added). As explained below, the statutes detailing confirmation and voting provisions do not contain any exception to this absolute priority rule in the case of a plan seeking confirmation over the non-acceptance of a creditor class. The "new value exception" to the absolute priority rule recognized by the Ninth Circuit below permits the owners of a debtor to retain the ownership of all the property of the debtor without paying in full the claims of the unsecured creditors – including the deficiency claims of secured creditors who would prefer to own the property and realize any later appreciation. The language of the Bankruptcy Code permits no such result.

There is no mention in the Bankruptcy Code of any exception to the clear and precise plan confirmation requirements of §1129(a) and §1129(b)(2)(B), which are unequivocal, without exception, and must be enforced as written. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241, (1989) (where the statute's language is plain the sole function of the court is to enforce it according to its terms) (quoting *Caminetti v. United States*, 242 U.S. 855 (1917)).

Indeed there is no reason for the "new value exception" to be applicable under the Bankruptcy Code since, as established below, the drafters of the Bankruptcy Code addressed and cured the problem giving rise to the adoption of the "new value exception".

B. Origin of the "New Value Exception" Under Prior Law.

The "new value exception" was judicially fashioned in response to the strict requirements of the corporate reorganization provisions of prior law, specifically §77B of the Bankruptcy Act of 1898 and its successor Chapter X of the Chandler Act of 1938. 5 Collier on Bankruptcy at 1100-1108, ¶ 1101.01[2] (Lawrence P. King ed. 1993). In order to protect individual dissenting creditors within accepting classes, it was provided that a plan could not be confirmed unless the plan was approved by the requisite majority of each class *and* judicially determined to be fair and equitable, *i.e.* met the absolute priority requirements.³ As a result, notwithstanding approval of the plan by the requisite majorities of members of each class of creditors, a plan designed by senior creditors to motivate and keep effective management by giving the prior owners/managers an equity interest in the reorganized enterprise could not be confirmed if a single creditor objected.

In *Case v. Los Angeles Lumber Prod. Co.*, 308 U.S. 106 (1939), the debtor (with overwhelming creditor support) attempted to circumvent this strict rule by arguing that

³ In short, in contrast to the present Bankruptcy Code confirmation requirements which are disjunctive, *viz.*, class acceptance *or* fair and equitable, the prior Bankruptcy Act requirements were conjunctive – class acceptance *and* fair and equitable. Under the present Bankruptcy Code, individual dissenting creditors are protected by, *inter alia*, the best interests of creditors test contained in 11 U.S.C. §1129(a)(7).

the old stockholders were paying for their retained interest in the reorganized entity by contributing their experience, contacts and management ability. This court rejected that argument stating that old equity could participate only if they paid for their interest in "money or money's worth" (*Id.* at 122). Thus this court created what became known as the "new value exception" to the absolute priority rule, under which junior interests (e.g. stockholders) could contribute new capital to a bankruptcy plan in exchange for an interest in the reorganized enterprise equal to the value of their contribution. Actually this is not an "exception" to the absolute priority rule, it is in fact an affirmation of the requirement of absolute priority and a rejection of attempts at "easy evasion of the principle of full or absolute priority" *Id.* (citations omitted)

Obviously, requiring payment of money for the interest was not the bargain that the senior creditors or old stockholders had in mind in the rejected plan in *Los Angeles Lumber*. They had agreed on equity participation without any payment. *Los Angeles Lumber's* "new value exception" did not solve the problem of the absolute priority rule permitting a single creditor to veto the plan approved by the requisite majorities of those who had an interest in the firm. When the Bankruptcy Code was being drafted, numerous suggestions were made for legislative changes that would deal with the problem by overcoming the rigid absolute priority requirements of Chapter X.

C. Congress Revises the Absolute Priority Rule.

On July 24, 1970, then President Nixon appointed the Commission on the Bankruptcy Laws of the United States ("Commission") to consider a review of the Bankruptcy Act. The Commission completed its work in July 1973 after an extensive study and submitted its Report ("Commission Report") containing a proposed new bankruptcy law. The Commission Report discussed the nature, development, justification and deficiencies of the absolute priority rule, noting that it had become a "straight jacket" since under it, equity security holders could not participate - even by agreement of all classes of creditors. Commission Report, Part I, at 256-57. The Commission's solution was to modify the absolute priority rule by permitting juniors who make a contribution important to the operation of the reorganized debtor to participate on a basis reasonably approximating the value of their contribution.⁴

⁴ The Commission Bill (H.R. Doc. No. 137, Parts I and II, Cong., 1st Sess. (1973) provided in §7-303(4) that the plan of reorganization:

may provide, if the court finds that . . . certain partners or equity security holders will make a contribution which is important to the operation of the reorganized debtor or successor under the plan, for participation by the individual debtor, such partners, or such holders under the plan on a basis which reasonably approximates the value, if any, of their interests and the additional estimated value of such contribution.

This proposal created a storm of controversy⁵ and was rejected by Congress. In its place, Congress modified the absolute priority rule in a different way, presently reflected in §1129 of the Bankruptcy Code, under which each class is free to agree by the requisite majority to accept a plan that affords the class less than absolute priority. Only where an impaired class rejects the plan is it entitled to absolute priority treatment. If §77B and Chapter X of the former Bankruptcy Act had contained a similar provision, the issue in *Los Angeles Lumber*, which gave rise to the creation of the "new value exception", would never have arisen.

Thus Congress dealt in a fundamental way with the problem for which the "new value exception" was developed. Senior classes of creditors are free to allow junior class participation if the senior class votes to accept such a plan. If a senior impaired class does not accept a plan, absolute priority must be provided or the plan cannot be confirmed as fair and equitable. See §1129(b)(2)(B)(ii). Any attempt to obviate the absolute priority requirements in court imposed plans (so-called "cramdown" plans) has no validity under the Bankruptcy Code as adopted by Congress.⁶

⁵ See e.g. Brudney, *The Bankruptcy Commission's Proposed "Modification" of the Absolute Priority Rule*, 48 Am. Bankr. L. J. 305, 337 (1974) and Note, *The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule of Corporate Reorganizations*, 87 Harv. L. Rev. 1786, 1817 (1974).

⁶ Some courts have argued that this Court's decision in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992) may require a finding that the new value "exception" survives the enactment of the Bankruptcy Code. This is not correct. While it is true as this Court

II. The Adoption of the "New Value Exception" by the Ninth Circuit and its Application to Single Asset Real Estate Reorganizations is a Distortion of the "New Value Exception" and Abrogates the Absolute Priority Requirements of the Bankruptcy Code.

As discussed above, given the Bankruptcy Code's extensive revisions to plan confirmation requirements, the "new value exception" has no *raison d'être* in the Bankruptcy Code. Assuming *arguendo*, this Court concludes that the "new value exception" is still a viable judicial supplement to Chapter 11, or if this Court declines to reach the issue of the "exception's" validity⁷, the Ninth Circuit should be reversed because the "new value exception" – as reformulated by the Ninth Circuit into the new value principle – is not the "new value exception" created by this Court in *Case v. Los Angeles Lumber*. In that decision, this Court concluded that a reorganization plan could permit a junior interest, with majority creditor consent, to participate in the reorganized entity only to the extent that the junior interest contributed money or money's worth to the enterprise.

stated in *Dewsnup* that Congress does not "write 'on a clean slate'" when it amends the bankruptcy laws, 112 S. Ct. at 779, no doctrine requires application of a pre-Code practice developed to meet a pre-Code requirement that no longer exists. As discussed above, it was the restrictive nature of the pre-Code absolute priority rule that resulted in the creation of the limited "new value exception". That restrictive nature has been removed from the Bankruptcy Code absolute priority provisions. Pre-Code practice cannot be said to survive into a new law that has eliminated the problem for which the practice was developed.

⁷ *Norwest Bank Worthington v. Ahlers*, 485 U.S. at 203, n.3.

Such participation would not violate the absolute priority rule because in the context of a multi-asset reorganization, no creditor's interest was adversely affected by the retention of an interest in exchange for a contribution. The junior's contribution "enlarged the pie" of available assets and the junior was entitled to an interest to the extent its funds resulted in the enlargement. See Salvatore G. Gangemi and Stephen Bordanaro, *New Value Exception: Square Peg in a Round Hole*, 1 Am.Bankr.Inst.L.Rev. 173, 194 and n.130 (1993).

Under the Ninth Circuit's version of the "new value exception", by making a contribution, the debtor's principals can keep the property - free of the interests of unsecured creditors including the mortgagee's substantial deficiency claim. Instead of enabling the junior interest holder to participate to the extent it enlarges the "pie", the Ninth Circuit permits the junior interest to keep the property in question, and any subsequent appreciation to the detriment of all unsecured creditors and the mortgagee's deficiency claim. This is clearly contrary to the spirit, language and purpose of the "new value exception" and this Court's decision in *Los Angeles Lumber*.

The reason the Ninth Circuit's decision so distorts the "new value exception" is that the "exception" is being applied to a court imposed single asset real estate plan. As observed above, the "new value exception" arose in the context of multi-asset reorganizations where there was some value to be distributed to creditors. In a single asset court imposed plan such as the instant case, the debtor has only one property and that property is worthless than the debt to the mortgagee. The undersecured mortgage has been reduced under §1129(b)(2)(A) of the

Bankruptcy Code to the value of the collateral as determined under §506(a) of the Bankruptcy Code. Since, the plan reduces the secured creditor's mortgage to 100% of the previously court-determined property value, the debtor's principals argue that there is no equity for unsecured creditors. The self-serving alchemy of the plan is then invoked. Any "substantial" contribution, the debtor's principals argue, will be sufficient to enable them to keep the property and discharge the claims of unsecured creditors.⁸

This concept, that if there is no equity in the property, the creditors have no rights, was specifically rejected by this Court in *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482, 508 (1913) where this Court stated:

"If the value of the [property] justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever." (emphasis added.)

228 U.S. at 508.

⁸ The inequity of such a scheme is particularly apparent in the commercial real estate industry where property values are affected little by management expertise and cyclical fluctuations are common. The Ninth Circuit's approach shifts the downside risk to the lenders.

Control is a property right and whether or not the court finds equity in the property, the creditors are entitled to the benefit of that control. This principle is embodied within §1129(b)(2)(B) and was specifically endorsed by this court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-09 (1989).⁹

The "new value exception" as reformulated and applied by the Ninth Circuit takes a rule designed to protect creditors and converts it to a rule under which the debtor and its principals can keep the assets of the enterprise without compensating unsecured creditors, thus abrogating the absolute priority requirements of §1129(b)(2)(B). This violates the Bankruptcy Code and rule of absolute priority rule as it has long been articulated by this Court.

⁹ See also *In re Outlook/Century Ltd.*, 127 B.R. 650, 656 (Bankr. N.D. Cal. 1991) where the court recognized that the plain language of §1129(b)(2)(B) does not permit any "new value exception":

The 'new value exception' is inconsistent with the principle of creditor control, because it would permit Debtor to force the plan of reorganization on creditors who do not believe that the plan is in their best interest and whom Debtor does not propose to pay in full. 127 B.R. at 657-658 (citations omitted).

III. The Ninth Circuit's Application of the "New Value Exception" is Contrary to the Express Provisions of §1129(b)(2) of the Bankruptcy Code.

A. Under the "New Value Exception" as Articulated by the Ninth Circuit, the Holder of the Secured Claim Will Not Receive the Allowed Amount of its Claim as Required by §1129(b)(2)(A)(i) of the Bankruptcy Code.

Section 1129(b) of the Bankruptcy Code provides that where a dissenting, impaired class of creditors rejects a plan, the plan may be confirmed notwithstanding this rejection by a class only if the plan is "fair and equitable" as to that class. With respect to secured classes, under §1129(b)(2)(A)(i), where the dissenting, impaired secured creditor's lien is retained under the plan, the plan is not fair and equitable as to that class if the lien does not have a value as of the effective date of the plan equal to the amount of the secured claim.

The amount of an undersecured creditor's claim is determined under §506(a) which provides that a claim is a secured claim to the extent of the value of the collateral and an unsecured claim to the extent that the debt exceeds the value of the collateral. In the instant case, the value of the collateral was determined under §506(a) and the mortgage was reduced to that value. Section 506(a) is subject to redetermination for various purposes during the reorganization including a redetermination in connection with "any hearing . . . on a plan affecting such creditor's interest." 11 U.S.C. §506(a).

The best indicia of the value of real property is what a person will pay for the property. In the instant case the

debtor's plan proposes that certain of its partners acquire the property subject to a mortgage equal to 100% of the earlier §506(a) determined property value upon the payment of an additional \$200,000. In other words, those partners are willing to buy the property for \$200,000 in excess of the §506(a) value. This indicates that the earlier valuation is incorrect and that the amount of the allowed secured claim should be increased to at least the amount the debtor's principals are willing to pay for the property. Unless the secured claim is increased to that amount, the secured creditor is being deprived of its interest in the collateral contrary to the express provisions of §1129(b)(2)(A).¹⁰

B. Under the "New Value Exception" as Reformulated by the Ninth Circuit, the Debtor Will Retain an Interest Without Providing the Unsecured Creditors with Property of a Value Equal to the Allowed Amount of their Claims Contrary to the Express Language of §1129(b)(2)(B).

Under §1129(b)(2)(B), for a plan to be fair and equitable as to an unsecured class of creditors, the debtor's owners may not receive or retain on account of their

¹⁰ The Plan may also be violative of §1129(a)(3), which requires that the plan be proposed in good faith. Where the court determines the value of the property under §506(a) based on information received from the debtor who is in control of the flow of information concerning the status of the property, and the debtor later proposes a plan under which the debtor's principals will be given the property for a price in excess of the court determined value, serious questions arise as to whether the good faith requirement has been met.

junior interests *any property* unless all members of a dissenting impaired unsecured class receive property equal to the full allowed amount of their claims.

The debtor's plan in the instant case provides that the debtor's prior owners retain their ownership interest in the debtor retaining the property while the dissenting unsecured class receives less than 10% of their claims. This is a clear violation of the provisions of §1129(b)(2)(B). The debtor's principals argue, however, that they are not retaining the property "on account of" their old ownership in violation of §1129(b)(2)(B)(ii), but are acquiring the interest for value, much as a third party could acquire the property by bidding for it. What the debtor ignores is that such acquisition, whether by the debtor or a third party bidder is not permitted under the Bankruptcy Code unless the interests of creditors are protected. The carefully drafted provisions of subsections (A) and (B) of §1129(b)(2) preclude such acquisition.¹¹ As

¹¹ In *Bonner Mall*, the Ninth Circuit transmogrifies the "new value exception" into the "new value principle" which – is an extra-statutory doctrine that specifically regulates the conditions under which plans calling for an infusion of capital by old equity in exchange for participation in a reorganized debtor may be confirmed in a cramdown.

2 F.3d at 910, n. 25. The Ninth Circuit acknowledges that "such a statutory exception does not exist." *Id.* Yet, it eagerly embraces as well-established law the concept of a cramdown plan – a lender's worst nightmare – by a route not specified by Congress when it defined fair and equitable treatment. The upshot of the Ninth Circuit's decision will be that any party unhappy with the limitations of the present Bankruptcy Code will rummage through repealed laws hoping to find some helpful doctrine. The requirements of a fair and equitable plan have been pain-

discussed above, the undersecured mortgage must equal the value of the collateral. A bid by a third party or by the debtor would determine the property value and raise the amount due under the mortgage. In other words, no plan under which the debtor or a third party keeps the property without compensating creditors in full may be confirmed over the objection of the unsecured creditor's class.

Thus the attempt to reformulate and apply the "new value exception" to cases involving undersecured mortgages on single asset properties is prohibited by the express provisions of the Bankruptcy Code.

IV. The Application of the "New Value Exception" to Single Asset Real Estate Reorganizations Serves No Public Purpose and Abrogates the Protection for the Mortgagee Built into the Bankruptcy Code.

A. No Public Purpose.

The application of the "new value exception" is often urged as a matter of public policy in order to keep the debtor in business, preserve the going concern value and keep people employed. While these objectives may be valid in connection with multi-asset reorganizations and industrial corporations, they are wholly inapplicable to single asset real estate cases.

stakingly articulated by Congress and there is no need to resurrect judicially created exceptions to an earlier Act's undefined version of the fair and equitable standard which exception was not adopted by Congress.

In a single asset real estate transaction, the debtor's business is the operation of the real property, which is leased to tenants who occupy space in the building. Such operation of real estate will be continued no matter who is the owner of the property. It is a non-sequitur to say that the "reorganization will fail" if there is no infusion of new value. The only thing that may fail is the debtor's principals' attempt to keep the property without paying creditors. If the plan cannot be confirmed and no plan consistent with the language of the Bankruptcy Code can be proposed, liquidation will follow and the mortgagee or other purchaser will acquire and operate the property. Tenants will still occupy space in the property; the tenants' employees will continue to be employed in the premises; whoever operates the property will continue to employ maintenance and other personnel. The question is not whether the business will continue. The question is only who will own the property – the debtor's principals who have not paid the debtor's obligations to creditors, or the creditors who have not been paid by the debtor. The decision below grants exclusive control and any appreciation rights to the debtor's principals.

B. Abrogation of Mortgagee Protection.

1. Absolute Priority.

The Ninth Circuit ignores the intent of Congress that reorganization plans be confirmed only if they are "fair and equitable" as to dissenting impaired classes. The plan at issue in the instant case is impermissibly unfair and inequitable with respect to the dissenting creditor class.

The debtor's principals are permitted to retain the mortgaged property in exchange for only a \$200,000 capital contribution while the dissenting creditor is forced to accept a pro-rata distribution of 300,000 shares of preferred stock in the new enterprise, which would be valued at \$1 per share, in full satisfaction of its deficiency claim of approximately \$3.4 million. In addition, the dissenting creditor will receive no interest in the property. This turns the concept of "risk capital" on its head since only the lender permanently loses value.

This Court has held that the dissenting creditor's interest in the debtor is a property right. *Northern Pacific Railway Co. v. Boyd*, *supra*, 228 U.S. at 508. In the instant case, U.S. Bancorp's property rights have been violated by the plan which permits the transfer of the property to the debtor's principals. The statutory framework set up by Congress requires that such decisions be negotiated by the debtor with its creditors. The absolute priority rule of §1129(b) is the basic ground rule for that negotiation process. It levels the playing field between the debtor's management, which controls the enterprise and its assets, and the debtor's creditors who, if the debtor is insolvent effectively own the enterprise. See *In re Outlook/Century Ltd.*, *supra*, 127 B.R. at 650.

Absolute priority is of critical importance to the mortgage lending industry. Absolute priority for the unsecured portion of the mortgagee's claim (the claim of the mortgagee in excess of the value of the collateral as determined under §506(a) of the Bankruptcy Code) is the linchpin in the package of protection designed by Congress to protect the mortgagee from attempts by the

debtor's principals to keep the property without paying creditors.

A major purpose of §1129(b)(2)(B) was to overcome the so-called *Pine Gate* line of cases that treated non-recourse mortgagees as the Ninth Circuit treats all mortgagees. See *In re Pine Gate Associates, Ltd.*, 2 Bankr. Ct. Dec. (CCH) 1478 (Bankr. N.D.Ga. 1976). Those cases under Chapter XII of the former Bankruptcy Act allowed borrowers to retain the mortgaged property while paying the non-recourse mortgagee the depressed value of the collateral, leaving such mortgagee with no compensation for the amount of the debt exceeding the property value, no control of the property, and no appreciation potential. *Bonner Mall* produces similar but harsher consequences for mortgagees since under *Bonner Mall* the mortgagee receives in lieu of cash equal to the value of the collateral, only a reduced mortgage in an amount determined by the court to be equal to the value of the collateral and deferred payments that the court has determined have a present value equal to the value of the collateral.

To overcome the *Pine Gate* inequity, Congress specifically provided in §1111(b)(1) of the Bankruptcy Code that every undersecured mortgagee would be able to have an unsecured claim for the debt in excess of the property value, and that the dissenting, impaired unsecured class would be afforded absolute priority. Thus, the debtor would not be able to retain the property while unsecured debts remain unpaid.¹²

¹² See 5 Collier On Bankruptcy, ¶ 1111.02[2] (L. King 15th ed. 1986); I. Cherkis, *Collier Real Estate Transactions and the Bankruptcy Code*, ¶ 1.11 (L. King ed. 1985); Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39

Under the *Pine Gate* line of cases, secured creditors willing to take the collateral in satisfaction of the debt were not permitted to do so. The plan would be confirmed and the secured creditors paid the value of their collateral which might be significantly less than their debt.¹³ Due to the non-recourse nature of the debt, the secured creditors would not have had an unsecured claim for their loss.¹⁴

2. Treatment of Absolute Priority Under the Bankruptcy Code

As a direct response to the inequity of the *Pine Gate* line of cases, Congress was asked to restore absolute priority to real estate arrangements and to overrule *Pine Gate*.¹⁵ Congress responded. It enacted a series of complex provisions as part of the Bankruptcy Reform Act of

BUS. LAW. 441 (1984); and S. Rep. No. 989, 95th Cong. 2d Sess. 65, reprinted in 1978 U.S. CODE CONG. ADMIN. NEWS 5851 (commenting on Section 502(i) in an earlier version of Section 1111(b)).

¹³ See *In re KRO Assoc.*, 4 Bankr. Ct. Dec. (CCH) 462 (Bankr. S.D.N.Y. 1978), where there were approximately \$14 million in mortgages on the property and the court found the value of the property to be \$895,000.

¹⁴ While in *Bonner Mall* the mortgagee has an unsecured claim, the decision renders that claim of little value because it does not afford it absolute priority. Thus the result under *Bonner Mall* is similar to *Pine Gate*.

¹⁵ See, e.g., Testimony of John J. Creedon on behalf of the American Council of Life Insurance, Hearings on S.2266 and H.R. 8200 Before the Subcommittee on Improvements in the Judicial Machinery, Senate Committee on the Judiciary, 95th Cong., 1st Sess. 853, 855-56 and 864-67 (1977).

1978 designed to protect the undersecured creditor by overcoming the *Pine Gate* rule. This package of protection included §§506(a), 1111(b) and 1129(b)(2). Together they insure that (i) the mortgagee may have a secured claim for the value of the collateral and an unsecured claim for the difference between the value and the amount of the indebtedness, and (ii) absolute priority for each of these claims.¹⁶

By effectively reading absolute priority for the unsecured claim out of §1129, the Ninth Circuit's decision undermines this Congressional package of mortgagee protection. The knot of protection for the mortgagee is tied with the absolute priority requirement for the unsecured claim. Under §1129(b)(2)(B), the dissenting impaired unsecured class must receive property of a value equal to the allowed amount of its claims before any junior interest receives any property.

Of course, there may not be property available to pay the unsecured claim in full. However, the debtor will not be able to retain its interest in the property unless such

¹⁶ Specifically, this package was designed to protect the mortgagee in the following manner: Section 1111(b) provides that a non-recourse claim will be converted to a recourse claim for the purpose of plan confirmation (unless a fully secured claim is elected under §1111(b)(2), not germane here) thus assuring that the non-recourse mortgagee will have a claim for the unsecured portion of the debt as determined under §506(a). Section 1129(b)(1) requires absolute priority for every class that is impaired and has not accepted the plan. Thus, whether a mortgage is recourse, or has been converted to a recourse claim, the mortgagee has absolute priority for both the secured and unsecured claim (assuming the unsecured class rejects the plan by the requisite majority).

debts are so paid. If the debtor in *Bonner Mall* is permitted to keep the property without fully paying unsecured claims, the foundation of mortgagee protection will have been removed from the Bankruptcy Code, and the mortgagee will have been relegated to a situation even more harmful than under *Pine Gate*. This result would impermissibly expand the "new value exception" and contravene both the intention of Congress and the express language of the Bankruptcy Code.¹⁷

V. If the Ninth Circuit's Decision is Allowed to Stand, It Would Have a Severe and Negative Impact on Borrowers, Lenders and the Real Estate Industry.

If not reversed, the decision below will have a severe adverse impact on the real estate industry. Literally billions of dollars of insurance policyholders, bank depositors, pensioners, trusts and mortgagees have been loaned to borrowers on the strength of real property collateral and the protection built into the Bankruptcy Code. These Bankruptcy Code provisions were written to protect lenders whose rights were seriously jeopardized by the *Pine Gate* rule and to mandate priorities not in the former Bankruptcy Act.

The decision below can only result in tighter credit standards and higher interest rates for borrowers. It not only threatens existing mortgage debt held by lenders,

¹⁷ See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 205 (1988), where this Court stated: "Even if Congress meant to retain the *Los Angeles Lumber* exception . . . it is clear that Congress had no intention to expand that exception any further."

but also threatens the future of the real estate industry, which relies so heavily on mortgage financing.

The Bankruptcy Code was carefully drafted by Congress to balance the interests of debtors and creditors and provide for the efficient administration of bankruptcy in the United States. If Courts are permitted by judicial legislation to undermine the foundations of the protection afforded to real estate mortgagees, the real estate industry and with it the national economy, will be severely and adversely affected.



CONCLUSION

For all of the reasons set forth herein, the American College of Real Estate Lawyers respectfully urges this Court to reverse the decision of the Ninth Circuit below.

Respectfully submitted,

CHRISTOPHER F. GRAHAM
THACHER PROFFITT & WOOD
Two World Trade Center
New York, New York 10048
(212) 912-7400

PROFESSOR ROBERT M. ZINMAN
St. John's University
School of Law
8000 Utopia Parkway
Jamaica, New York 11439
(718) 990-6646

*Attorneys for American
Counsel of Real Estate
Lawyers*

EXHIBIT A

STOEL RIVES BOLEY
JONES & GREY

Attorney at Law
16th Floor
One Union Square
600 University Street
Seattle Washington 98101-3197

Telephone (206) 624-0900
Telefax (206) 386-7500 MCI Mall No. 495-5830
Complaint No. 624-7580 TDD (206) 628-6206

(206) 386-7634

February 18, 1994

VIA FACSIMILE

Chris Graham, Esq.
Thacher Proffitt & Wood
Two World Trade Center
New York, N.Y. 10048

Re: In re Bonner Mall Partnership - Supreme Court
#93-714

Dear Mr. Graham:

Pursuant to Rule 37.3 of the Rules of the Supreme Court, we hereby grant consent to you to appear as *amici curiae* in the above-referenced case.

Very truly yours,

/s/ Bradford Anderson
Bradford Anderson
